94th Congress }
2d Session }

COMMITTEE PRINT

THE ACCOUNTING ESTABLISHMENT

A STAFF STUDY

PREPARED BY THE

SUBCOMMITTEE ON REPORTS, ACCOUNTING AND MANAGEMENT

OF THE

COMMITTEE ON GOVERNMENT OPERATIONS
UNITED STATES SENATE

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SUBCOMMITTEE ON REPORTS,
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(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

7 December 1976

The Honorable Abraham Ribicoff
Chairman
Senate Government Operations Committee
Washington, D.C. 20510

Dear Chairman Ribicoff:

Late last year, this subcommittee began a study of the Federal government's role in establishing accounting practices which are used by publicly-owned corporations in reporting financial and other information to the public. The study was precipitated by continual revelations of previously unreported wrongdoing by major corporations, as well as a series of corporate failures and financial difficulties which have come to light in recent years. In many cases, the problems which occurred were caused or aggravated by the use of accounting practices that failed to reflect accurately the substance of corporate business activities.

Congress and the public have a very real interest in assuring that information reported by corporations is both meaningful and accurate. Accounting practices are instrumental in achieving that result because they control the manner in which corporate financial information is presented and checked for accuracy. Corporations presently have substantial discretion in choosing among alternative accounting standards to report similar business transactions. As a result, the amounts of earnings or losses reported to the public can vary drastically depending on which accounting alternatives are chosen.

Congress recognized the importance of accounting practices to achieving meaningful corporate disclosure in the Federal securities laws which were enacted more than 40 years ago.

The Honorable Abraham Ribicoff
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The Securities and Exchange Commission was given broad authority to establish accounting practices as part of its mandate to protect the public from false and misleading information regarding the activities of publicly-owned corporations. The SEC's failure to exercise its authority on accounting matters has led to many of the problems which have caused a serious erosion of public confidence in the accuracy and usefulness of information reported by corporations.

I am transmitting to you the completed study by the subcommittee staff, which is entitled "The Accounting Establishment" after an apt characterization by the chairman of the Financial Accounting Standards Board. The major purpose of this study is to provide Congress and the public with an understanding of the various private organizations and Federal agencies involved in establishing and administering accounting practices which have substantial impact on Federal policies and programs, as well as private economic decisions.

In the course of preparing this study, the subcommittee found it necessary to request certain information directly from the organizations and agencies involved in establishing accounting practices because relevant factual data was not readily available to Congress and the public. Thus, the study and its appendices provide a useful and convenient reference concerning the identities and activities of those organizations and agencies comprising the accounting establishment. Such a comprehensive reference on this important area of public policy and controversy is long overdue.

I believe the findings of this study should be of concern to every Member of Congress who believes that the success of our competitive economy depends upon the free flow of accurate and meaningful information regarding the activities of its major participants -- the publicly-owned corporations which provide much of the Nation's goods and services. Congress has established as a national policy that a proper role for the Federal government should be to ensure the free flow of such information, but that goal has not been adequately fulfilled. This study explains some of the primary reasons why adequate corporate disclosure has not been achieved.

The Honorable Abraham Ribicoff
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In particular, I am disturbed by two of the study's major findings. The first is the extraordinary manner in which the SEC has insisted upon delegating its public authority and responsibilities on accounting matters to private groups with obvious self-interests in the resolution of such matters. The second is the alarming lack of independence and lack of dedication to public protection shown by the large accounting firms which perform the key function of independently certifying the financial information reported by major corporations to the public.

Based upon its analysis of all the information reviewed during the course of this study, the subcommittee staff has prepared several recommendations which are designed to restore public confidence in the integrity and usefulness of corporate financial reports, and help fulfill the intent of the Federal securities laws. I believe those recommendations serve as sound guidelines for action by Congress to achieve necessary reforms of accounting practices. I also note that this study and its recommendations complement the work being done by other committees within the House and Senate on regulatory reform and corporate disclosure.

Interest in this subcommittee's work by the accounting profession, the business community, the academic community, and Federal agencies concerned with accounting matters indicates there will be widespread interest in this study outside of Congress. Therefore, I ask that the study be issued as a committee print.

The voluntary cooperation of the major accounting firms, private accounting and business organizations, and Federal agencies which provided information to the subcommittee is appreciated.

Very truly yours,

Lee Metcalf

GLOSSARY

Accountant.—An accountant is a qualified person who performs auditing and accounting services. Accountant is generally used as a synonym for CPA in this study.

Accounting and Accounting Standards.—Accounting involves the principles and practice of systematically recording, interpreting, and presenting financial information. Accounting standards are the principles or methods that govern the manner in which financial information may be presented.

Accounting Series Release.—Accounting series releases are policy statements and administrative actions on accounting matters which are issued by the SEC.

American Accounting Association.—The American Accounting Association is a professional organization which primarily represents the interests of academic accountants. It is one of the private groups sponsoring the FASB.

Auditing and Auditing Standards.—Auditing involves the periodic examination of financial statements and checking of business records to verify their accuracy. Auditing standards govern the manner in which audits should be conducted.

AICPA.—AICPA is the abbreviation for American Institute of Certified Public Accountants, the largest professional association of CPAs. The AICPA is one of the private groups sponsoring the FASB.

CASB.—CASB is the abbreviation for Cost Accounting Standards Board, a Federal board established to promulgate cost accounting standards for use by contractors with the Federal Government.

Cost Accounting Standards.—Cost accounting standards are used to measure and allocate costs under contracts.

CPA.—CPA is the abbreviation for certified public accountant. Such accountants are certified by State examining boards as having met the requirements of State laws regarding certain qualifications to practice accounting. CPAs may serve as independent auditors for publicly-owned corporations.

"*Creative Accounting*".—The term "creative accounting" is widely used to describe accepted accounting techniques which permit businesses to report financial results that may not accurately portray the substance of their business activities.

FAF.—FAF is the abbreviation for the Financial Accounting Foundation, which is the non-profit corporation formed to operate the FASB organization.

FASAC.—FASAC is the abbreviation for the Financial Accounting Standards Advisory Council, a part of the FASB organization intended to provide outside advice to the FASB.

FASB.—FASB is the abbreviation for the Financial Accounting Standards Board, which is the private body created to establish accounting standards.

Financial Accounting Standards.—Financial accounting standards govern the presentation of financial information by publicly-owned corporations and other businesses to investors, creditors, and the public.

Financial Analysts Federation.—The Financial Analysts Federation is a professional association of securities analysts. It is one of the private groups sponsoring the FASB.

Financial Executives Institute.—The Financial Executives Institute is an organization that promotes corporate business interests. It is one of the private groups sponsoring the FASB.

GAAP.—GAAP is the abbreviation for generally accepted accounting principles, which comprise the collection of accounting standards presently available for use in reporting financial information of publicly-owned corporations and other businesses.

GAAS.—GAAS is the abbreviation for generally accepted auditing standards, which are the standards presently used to guide independent auditors in checking the business records of publicly-owned corporations and other businesses for accuracy and consistency.

Independent Auditor.—Independent auditor, as used in this study, is the designation for a CPA or other qualified accountant who independently certifies the accuracy of corporate financial information under the provisions of the Federal securities laws. When acting as the independent auditor of a publicly-owned corporation, an accountant has public responsibilities and must satisfy requirements of the Federal Government regarding performance of those responsibilities.

NASBA.—NASBA is the abbreviation for National Association of State oBards of Accountancy, an organization purporting to represent State boards which license CPAs.

National Association of Accountants.—The National Association of Accountants is an organization representing businessmen and accountants. It is one of the private groups sponsoring the FASB.

Partners.—Because most accounting firms are organized as business partnerships, partners in such firms are responsible for the firms' activities and receive a share of the firms' profits.

"*Principals*".—"Principals" are persons associated with accounting firms who are not CPAs, but provide senior level expertise in the performance of non-accounting services such as management advisory services. Responsibilities and financial remuneration of "principals" are generally comparable to those of partners with similar authority.

Practice of Accounting.—Practitioners or practicing accountants are those who provide professional services to clients on a fee basis, as distinguished from accountants who are employed by businesses, governments, or as academics.

Publicly-Owned Corporations.—As used in this study, publicly-owned corporations are those required to report information under the Federal securities laws. Such corporations generally have publicly traded securities and diversified ownership, and comprise the vast majority of the Nation's sizable corporations.

SEC.—SEC is the abbreviation for Securities and Exchange Commission, the Federal agency charged with administration and enforcement of the Federal securities laws.

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HASKINS & SELLS

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PRICE WATERHOUSE & CO.

TOUCHE ROSS & CO.

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(A Library of Congress, Congressional Research Service study by John Spriggs economic analyst, Economics Division.)

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COOPERS & LYBRAND

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SUMMARY

The accounting establishment in the United States is primarily comprised of the Nation's eight largest accounting firms, certain influential CPA professional organizations and business lobbying groups, and a few Federal agencies—most notably the Securities and Exchange Commission. This study examines the inter-relationships and activities of those private groups and Federal agencies in order to determine their impact on accounting practices promulgated or approved by the Federal Government.

The purpose of this study is to inform Congress and the public regarding the participants involved in developing and applying accounting practices which significantly affect government policy, the economy and society in general. Concise factual information regarding the accounting establishment has not previously been readily available to Congress and the public. This study and its appendices provide information necessary to formulate sound Federal policy on accounting matters.

Accounting standards govern the presentation of information in corporate financial statements. Enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934 created a need for accountants to act as independent auditors for publicly-owned corporations by requiring that certain information reported to the public by corporations be independently certified. The "Big Eight" and other large accounting firms have prospered from this Federal requirement because they are retained as the auditors for the Nation's major corporations. Such auditors are responsible for providing independent certification that corporate financial statements present fairly and accurately the results of business activities.

Independent auditors must have the complete confidence of the public for whose benefit the Federal securities laws were enacted. That confidence can only be maintained by strict adherence to standards of conduct which assure the public that auditors are truly independent and competent to perform their responsibilities. Even the appearance of bias or conflict of interest by an independent auditor can erode the public confidence necessary to make the disclosure policy embodied in the Federal securities laws successful.

The primary purpose of the Federal securities laws is to instill public confidence in the reliability and accuracy of information reported by publicly-owned corporations. Doubts as to the reliability and accuracy of such information impair its usefulness to the public for making efficient economic and social decisions, and defeat the purpose of the securities laws. Independent auditors perform a key function in achieving the goal of the Federal securities laws because they provide the means for independently checking and confirming the information reported by corporations.

Historically, Congress and the public have regarded accounting as an arcane subject better left to accountants themselves. Continual revelations of wrongdoing by publicly-owned corporations have caused a new awareness of the importance of accounting practices in permitting such abuses to occur. Unexpected failures of major corporations have led to requests for substantial assistance to such companies from taxpayers. Accounting practices ultimately involve social issues that affect the Nation's economic welfare.

Because of their broad social and economic significance, accounting issues must be addressed by Congress and the public in a manner which ensures that the public interest is protected. If past abuses are to be prevented in the future, it is important that the accounting establishment, which has permitted many abuses to occur, be understood. Accounting issues are too important to be left to accountants alone.

CHART 1

CONTROL OF THE "BIG EIGHT" ACCOUNTING FIRMS AND THE AICPA OVER ACCOUNTING STANDARDS APPROVED BY THE SEC

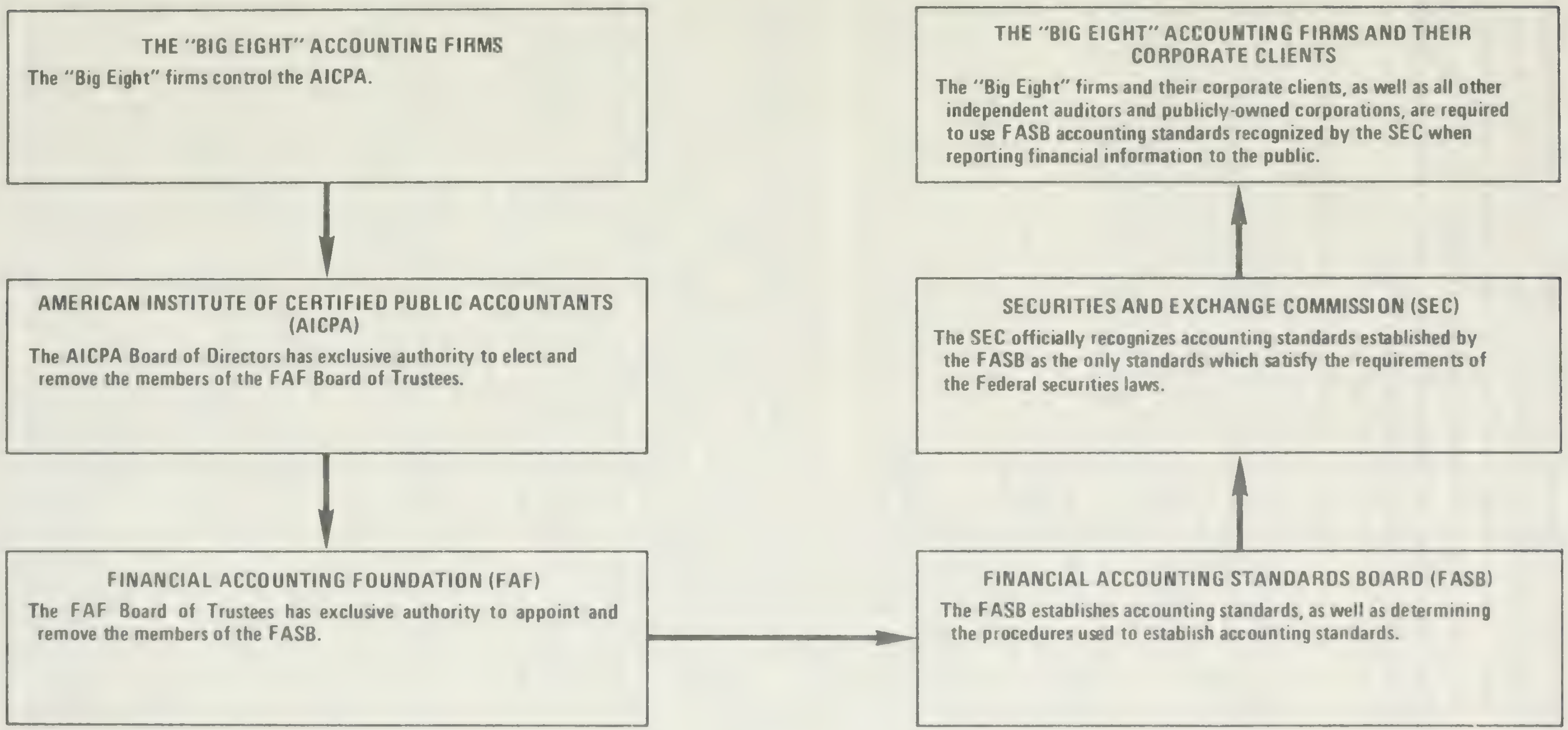

Chart 1 on page 3 provides a basic outline of the relationship among major organizations described in this study. The various boxes in Chart 1 identify the primary segments of the accounting establishment and their roles in the extraordinary process by which public authority to set accounting standards has been delegated to self-interested private parties. Chart 1 is a useful guide for summarizing the information contained in this study.

THE "BIG EIGHT" ACCOUNTING FIRMS

Chart 1 shows that the first major segment comprising the accounting establishment is the "Big Eight" accounting firms which are described in Chapter I. These eight firms are so big and influential in relation to other accounting firms that they dominate the practice of accounting in the United States and probably throughout the world. Listed alphabetically, the "Big Eight" firms are:

Arthur Andersen & Co.,
Arthur Young & Co.,
Coopers & Lybrand,
Ernst & Ernst,
Haskins & Sells,
Peat, Marwick, Mitchell & Co.,
Price Waterhouse & Co., and
Touche Ross & Co.

The "Big Eight" firms provide auditing and accounting services for the vast majority of major corporations. The next seven largest accounting firms in the Nation are important, but do not match the "Big Eight" in terms of size and influence.

The "Big Eight" are often called "public accounting firms" or "independent public accounting firms." This study finds little evidence that they serve the public or that they are independent in fact from the interests of their corporate clients. For that reason, this study refers to the "Big Eight" simply as accounting firms.

Information on the "Big Eight" firms and other private segments of the accounting establishment is not readily available to Congress and the public from published sources. Therefore, it was necessary for this subcommittee to request information directly from the "Big Eight" and other private groups. Additional information was obtained from Federal agencies and other sources within and without the accounting profession.

The "Big Eight" firms are large organizations. Each has several hundred partners, and their supporting staffs range in size from approximately 4,000 to over 8,000 persons. They maintain offices in every major city in the United States, and have affiliations in major cities overseas.

The influence exercised by the "Big Eight" firms far exceeds that which might be expected from the number of CPAs working for them. Only about 11 or 12 percent of the Nation's estimated 160,000 CPAs are associated with "Big Eight" firms, but their influence is magnified because their clients are the largest and wealthiest corporations in the United States. Because of their large size, the "Big Eight" firms exercise substantial influence directly on accounting practices promul-

gated or approved by the Federal Government. They also exercise substantial indirect influence through the American Institute of Certified Public Accountants (AICPA), which they control, and through the accounting practices followed by their corporate clients.

On the average, the "Big Eight" firms receive approximately 70 percent of their total revenues from performing auditing and accounting services, 18 percent from performance of tax services, and the remainder from performing management advisory services. Auditing and accounting services involve designing a reliable system of record-keeping for businesses, checking the record-keeping system periodically to assure that it is effective, providing assistance in presenting financial information so that it accurately conveys the results of business activities, and certifying financial statements for accuracy. Tax services involve helping clients achieve maximum financial benefits from provisions of Federal, State, local, and foreign tax laws.

Performance of management advisory services involves helping a client to manage its business, and goes beyond the expertise normally associated with the practice of accounting. The "Big Eight" accounting firms provide management consulting services such as executive recruitment, marketing analysis, plant layout, product analysis, actuarial services, and financial management services. All eight firms employ professionals, termed "principals," (who are not CPAs) to provide expertise in performing non-accounting management advisory services.

The supply of auditing and accounting services to corporations listed on either the New York Stock Exchange or the American Stock Exchange is heavily concentrated among the "Big Eight" firms. A study performed by the Congressional Research Service for this subcommittee found that 85 percent of the 2,641 corporations listed on the New York Stock Exchange and the American Stock Exchange are clients of "Big Eight" firms. Those clients accounted for one-half of the $2,552 billion in sales for the Nation's manufacturing, trade, and retail sectors and about 84 percent of the $75.4 billion of corporate profits after taxes, using average annual data for the years 1974 and 1975.

Concentration of major corporate clients among the "Big Eight" firms is greatest on the New York Stock Exchange where the largest corporations are listed. "Big Eight" accounting firms have 92 percent of the companies listed on that exchange as clients. For all the corporations listed on the New York Stock Exchange, the clients of "Big Eight" firms accounted for 94 percent of all sales (revenues) received, 94 percent of all profits earned, 90 percent of all income taxes paid, 94 percent of all people employed, and 94 percent of all assets owned.

A single "Big Eight" firm—Price Waterhouse & Co.— provides auditing and accounting services for clients that account for 24 percent of the sales and 28 percent of the earnings on the New York Stock Exchange. Four other firms—Arthur Andersen & Co., Coopers & Lybrand, Haskins & Sells, and Peat, Marwick, Mitchell & Co.—collectively are the auditors for 50 percent of the sales and 51 percent of the earnings for all of the corporations on that exchange. Thus, five of the "Big Eight" accounting firms collectively audit 74 percent of the total sales and 79 percent of the total net earnings of corporations listed on the New York Stock Exchange.

On the American Stock Exchange, 76 percent of the corporations listed are audit clients of "Big Eight" firms. For all the corporations listed on the American Stock Exchange, those clients account for 67 percent of all sales (revenues) received, 67 percent of all profits earned, 66 percent of all income taxes paid, 61 percent of all people employed, and 73 percent of all assets owned.

Again, the clients of Price Waterhouse & Co. account for the most revenue and income, about 16 percent of the total sales and 19 percent of the total net income of corporations listed on the American Stock Exchange. When the clients of Price Waterhouse & Co. are grouped with those of Arthur Andersen & Co., Coopers & Lybrand, Haskins & Sells, and Peat, Marwick, Mitchell & Co., those five firms are the auditors for clients that produce 45 percent of the sales and 49 percent of the earnings for all the corporations listed on the American Stock Exchange.

The Congressional Research Service found that the concentration of corporate clients among those five "Big Eight" firms was even greater when only the Nation's 50 largest corporations are considered. Analysis of the auditors for the 10 largest companies in six selected industries also showed concentration among certain "Big Eight" accounting firms. For example, Price Waterhouse & Co. clients include six of the 10 largest oil companies—Exxon, Gulf, Standard Oil of California, Standard Oil of Indiana, Royal Dutch Petroleum and Shell.

As independent auditors for major corporations, the "Big Eight" firms exercise great influence over the financial results shown by those corporations. The accounting establishment has permitted the evolution of a system of flexible, alternative accounting methods to report similar business transactions. Drastically different financial results can be reported to the public merely by using alternative accounting methods selected from the collection of acceptable methods.

Independent auditors must agree with the accounting methods used by a corporation in order to certify to the public that the corporation's financial statements present fairly the results of its operations. The present system of flexible, alternative accounting standards allows an independent auditor to use a great deal of discretion in approving various accounting methods. The method approved by the independent auditor can mean the difference between a corporation reporting healthy profits or severe losses to investors and the public.

The independent auditor is also responsible for certifying the accuracy of corporate records to the public. Present auditing standards permit an independent auditor to use a great amount of discretion in determining how much testing of corporate records should be done. In order to maintain the confidence of investors, government authorities and the public, corporations must receive unqualified endorsement from their independent auditors regarding the integrity of business records.

Because independent auditors presently exercise significant discretionary influence and are intimately involved in the presentation of corporate financial statements, the adverse effects traditionally associated with excessive market concentration are aggravated by the dominant position held by the "Big Eight" firms in supplying audit-

ing and accounting services to major corporations. Excessive market concentration traditionally causes problems concerning the price and availability of goods and services. The concentration of major corporations as clients of the "Big Eight" indicates a need for an investigation of possible anti-competitive effects.

Through the various services they provide, individual "Big Eight" firms have become involved in the affairs of more than one client competing within the same industry. Excessive concentration in the supply of auditing and accounting services exists among all industries, and often within the same industry. The AICPA committee structure provides the "Big Eight" accounting firms with an opportunity to promote anti-competitive practices by meeting together privately and establishing important auditing and accounting policies.

Concentration in the supply of auditing and accounting services appears to be increasing as a result of corporate mergers and the sale of corporate securities to the public. Small and medium-sized accounting firms usually lose clients to the "Big Eight" when smaller companies "go public" or are acquired by major corporations.

The practice of accounting is very profitable for partners in "Big Eight" firms, especially for the top partners who determine the policies followed by the firms. Collectively, the "Big Eight" firms have estimated total annual revenues of over $2 billion and net earnings for their partners of more than $500 million. The substantial financial interests at stake indicate that the firms have a strong vested interest in avoiding changes in the present system which might reduce the value of their services to clients.

Serious questions have been raised concerning the independence and competence of the "Big Eight" accounting firms and other independent auditors. Those questions have arisen because of accounting and auditing problems involved in the Penn Central collapse, the Equity Funding fraud, improper and illegal activities by Gulf Oil Corp. and Northrop Corp., and the many other abuses by corporations which have come to public attention in recent years. A common complaint in such cases has been, "Where was the independent auditor?"

Doubts as to the accuracy and reliability of information reported by corporations have resulted from continual revelations of corporate misconduct which was not found or not reported by independent auditors. Congress and the public have little assurance that corporate financial statements accurately portray the results of business activities because of flexible, alternative accounting standards. Public confidence in independent auditors, which is essential to the success of the Federal securities laws, has been seriously eroded.

This study finds that public doubts concerning the performance of independent auditors of major corporations are well founded. Moreover, the problems causing an erosion of confidence in the "Big Eight" accounting firms and other independent auditors are inherent in their present system of practice, the procedure by which they are chosen, and their relationship to standard-setting bodies. Restoration of public confidence in the independence and competence of such auditors depends upon reforming the manner in which they perform their responsibilities.

The most important requirement of independent auditors is that they be regarded by the public as truly independent from the interests of

their clients. The "Big Eight" firms have seriously impaired their independence by becoming involved in the business affairs of their corporate clients, and by advocating their clients' interests on controversial issues. It appears that the "Big Eight" firms are more concerned with serving the interests of corporate managements who select them and authorize their fees than with protecting the interests of the public, for whose benefit Congress established the position of independent auditor.

The management advisory services provided by "Big Eight" firms are intended to aid corporate managements in operating their businesses, and necessarily involve "Big Eight" firms in the business affairs of their clients. Such involvement creates a professional and financial interest by the independent auditor in a client's affairs which is inconsistent with the auditor's responsibility to remain independent in fact and in appearance.

When a "Big Eight" firm recruits executives for a corporate client, shareholders and the public may wonder if the firm is retained as the client's independent auditor primarily because of the relationship existing between the firm and the influential executives it recruited. Similarly, the public may reasonably doubt the ability of a "Big Eight" firm to act as independent auditor for a corporate client which has also retained the firm to provide marketing analysis, financial management services, actuarial services, or other management advisory services. In such cases, an independent auditor not only becomes involved in the business affairs of its clients, but may be placed in the position of auditing its own work.

Representation of clients' interests is another area where the "Big Eight" accounting firms have failed to meet their responsibility to remain independent. They advocate the partisan interests of their corporate clients on controversial issues, both for a fee and as a "public service." Partners of "Big Eight" firms join recognized business lobbies and actively represent them before Federal, State, and local governments.

"Big Eight" firms have advocated the interests of corporate clients on substantive political issues regarding taxation of corporations. They have supported increased investment tax credits, more liberalized depreciation methods, continuation of tax credits rather than deductions for taxes paid to foreign governments, and other procedures designed to increase the amount of cash held by big corporations. Advocacy of controversial positions involving the fair distribution of taxes results in a loss of independence because the auditor's interests become associated with the interests of clients or some other special interest group.

The "Big Eight" accounting firms readily identify with the self-interests of corporate managements on many other controversial issues. They testify before State regulatory commissions on the amount of profits which should be earned by regulated utilities, and in support of automatic cost adjustment clauses which circumvent the regulatory process. "Big Eight" firms support inclusion of construction work in progress in regulated utility rate bases, as well as charging utility customers for Federal income taxes that are never paid to the Federal Government.

They testify before Congress in support of higher oil and natural gas prices, and for faster write-offs of production costs. "Big Eight"

firms write to Federal agencies to urge adoption of rules that would have the Federal Government pay private contractors for "costs" that are not normally accepted costs at all. They oppose more stringent Federal regulations on reporting by corporations, and recommend that the Federal Government not adopt uniform accounting methods.

Independent auditors are endowed with a public reputation for impartiality and objectivity because of the special role assigned to them by Congress in the Federal securities laws. Their statements and recommendations are accorded great respect and credibility because of the general belief that such statements and recommendations are made independently. Thus, it is highly improper for them to use their special status as a basis for advocating the self-interests of their corporate clients, especially for profit.

The competence of the "Big Eight" accounting firms as independent auditors has also been questioned in recent years. Three of them have been officially disciplined by the SEC for auditing failures. Several of the "Big Eight" firms have been involved in legal actions resulting in adverse settlements because of alleged auditing failures.

The "Big Eight" firms provide auditing, accounting, and management advisory services to Federal, State and local governments as well as corporations. Through their employment, they are able to influence governmental policies and procedures which may affect the business activities of their corporate clients. The influence of the "Big Eight" firms on governmental policies and procedures can be substantial in certain areas, and may represent a conflict of interest with respect to services performed for clients in the private sector.

The total revenues received by the "Big Eight" firms for services to the Federal Government amounted to $16,486,000 in 1975. That was more than double the $8,037,000 received in 1971. Performance of services for the Federal Government appears to be of increasing importance to the "Big Eight" accounting firms.

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Chart 1 on page 3 shows that the American Institute of Certified Public Accountants (AICPA) is the first major step in the process by which the "Big Eight" firms are able to control the establishment of accounting standards used by their corporate clients. The AICPA is the largest professional association of CPAs and the most important private group affecting the practice of accounting. It dominates all significant aspects of accounting because the accounting profession is largely self-regulated, and Federal and State authorities have recognized policies and procedures established by the AICPA as representing decisions by the accounting profession. Chapters II, III and IV of this study describe the AICPA and its activities.

The AICPA is organized in a manner which permits the parties controlling its power structure to maintain their control over the organization. The "Big Eight" firms effectively control the power structure, and use the AICPA to advance their collective interests. The AICPA's power structure is comprised of its council, its board of directors, its president and administrative staff, and its important committees which establish AICPA policies and procedures. (See Chart 2 on page 72.)

Although CPAs associated with the "Big Eight" account for only 15 percent of the AICPA's 117,695 members, they comprised 31 percent of the 252 members on its council in fiscal 1976. The 15 largest accounting firms comprised 42 percent of the council membership. Through control of the AICPA's power structure, the "Big Eight" firms are able to assure that most council members agree with their views.

The AICPA's board of directors has broad authority to set policies and manage its resources. In fiscal 1976, six of the 18 board members, including the immediate past chairman of the board and the designated next board chairman, represented "Big Eight" firms. Nine of the 18 board members were from the 15 largest accounting firms.

The real work of the AICPA in terms of performing certain tasks and accomplishing specific goals is handled almost exclusively by its committee structure. The 108 committees listed and described in the 1975–76 AICPA Committee Handbook cover every topic of interest to the accounting profession. While the influence of the "Big Eight" firms pervades the AICPA committee structure, their representation is concentrated on committees performing work in substantive areas that have an extensive impact on the actual practice of accounting, and frequently affect governmental policies. "Big Eight" representation exceeded 50 percent on several of the most important committees in fiscal 1976.

The AICPA bylaws provide that the five most important committees—called senior technical committees—shall speak for the AICPA in their respective areas without consulting either the council or the board of directors. Because Federal agencies and State boards of accountancy charged with regulating accountants have chosen to rely upon the AICPA to such a great extent, the pronouncements of senior technical committees have become the prescribed standard followed by CPAs in several substantive areas. The public and the accounting profession are profoundly influenced by the activities of senior technical committees, but these autonomous committees have no procedural guarantees to protect the interests of those not actually represented on the committees.

The "Big Eight" firms dominate all five senior technical committees. Through these committees, they are able to determine the AICPA's policies and direct its activities on such important matters as accounting standards, auditing standards, management advisory services, Federal taxation, and professional ethics. The senior technical committees theoretically speak for the entire membership of the AICPA in those five areas of vital interest to CPAs and the public.

The Auditing Standards Executive Committee, one of the senior technical committees, performs an especially important function. It develops the AICPA's positions on proper auditing procedures which are issued as Statements on Auditing Standards. The Federal Government, State governments, and courts of law generally recognize those standards as the ones which must be followed by all CPAs.

Chart 1 on page 3 illustrates the process by which the "Big Eight" firms and the AICPA control the establishment of accounting standards. Accounting standards are important because they govern the manner in which businesses must present financial information to the public.

The process by which the Auditing Standards Executive Committee sets auditing standards on behalf of the AICPA is more direct and tightly controlled. Auditing standards equal accounting standards in importance because they govern the procedures used by accountants to check the accuracy and reliability of business records supporting financial statements. The legal liability of accountants in cases involving fraud or other illegal activities by corporate managements is often determined by their compliance with recognized auditing standards.

In fiscal 1976, eight of the 21 members on the Auditing Standards Executive Committee, including the chairman, represented the "Big Eight" firms. The combined representation of the Nation's 15 largest accounting firms was 14, or two-thirds of the total committee membership.

The "Big Eight" accounting firms also dominate the several AICPA committees established to advise the Federal Government, such as the Cost Accounting Standards Board Committee, the Federal Government Executive Committee, the Federal Taxation Executive Committee, and the SEC Regulations Committee. When the AICPA speaks to the Federal Government, it is the voice of the "Big Eight" and, to some extent, the next seven largest accounting firms.

Several other important committees are dominated by the "Big Eight" accounting firms. An example is the Planning and Finance Committee which determines the compensation of AICPA staff officers. The 15 largest accounting firms also have their own exclusive advisory committee to promote their interests within the AICPA.

The AICPA is a big organization which spent over $18 million on its various activities in fiscal 1975, including $589,000 just to influence the Federal Government. Another $187,000 was spent on Federal taxation matters. The "Big Eight" firms have used their influence to guide the AICPA into a broad range of activities intended to benefit their interests.

In addition to the professional education and ethics enforcement activities undertaken by most other professional associations, the AICPA engages in activities designed to increase its power over the practice of accounting. It controls the establishment of accounting and auditing standards. It develops and grades the Uniform CPA Examination used to test CPA applicants in every State. The AICPA also provides substantial support to the National Association of State Boards of Accountancy, an organization which purports to represent the State boards that regulate CPAs.

The AICPA is an active political organization. It has established a "key man" program to influence Members of Congress. The purpose of the program is to combat "government intervention in the profession's affairs" occasioned by an "anti-business" attitude in Congress, according to the AICPA's chairman of the board.

Representatives of the AICPA testify before Congress and make presentations to Federal agencies and departments. The AICPA lobbies Congress on both accounting and non-accounting matters. One of its major projects is to influence Federal taxation policies.

The AICPA biennially prepares a booklet entitled "Recommended Tax Law Changes" which it distributes to all Members of Congress. Four "Statements of Tax Policy" on controversial tax issues have also been prepared and distributed. The AICPA's recommendations con-

sistently support more tax benefits for the accounting profession's business clients.

Many AICPA members, especially those in large accounting firms, act as independent auditors for publicly-owned corporations, and are required to be independent of their clients' interests in fact and appearance. However, the AICPA does not hesitate to identify the interests of CPAs with those of their business clients. The accounting profession's reputation for objectivity and impartiality, as embodied in its preeminent professional association, is used by the AICPA to promote the partisan interests of the "Big Eight" firm's corporate clients.

Another major AICPA project is to expand the use of CPA services by the Federal Government. This understandable effort is accompanied by statements of the benefits to be realized by the Federal Government because CPAs possess great expertise and follow strict standards. The AICPA also recommends that CPAs be hired under cost-plus type contracts rather than fixed-cost contracts, and that the Federal Government "indicate the price it has in mind" so that prospective contractors will know how much to bid.

While the AICPA promotes the capabilities of CPAs to departments and agencies of the Federal Government with money to spend, it cautions Federal enforcement authorities that only limited results can be expected from audits performed by CPAs. It advocates legislation to limit the legal liability of CPAs for performing faulty or incomplete audits. The AICPA sometimes takes contradictory positions to promote different purposes before different parties.

Actions by the SEC, the Cost Accounting Standards Board, the Internal Revenue Service, and other Federal agencies and departments often affect the "Big Eight" firms or their corporate clients. The AICPA exerts special effort to maintain liaison with such agencies and departments in order to influence their activities. The views espoused by the AICPA usually reflect those of the "Big Eight" accounting firms and their big corporate clients.

Federal employees serve on certain AICPA committees which are specifically assigned to influence Federal policies and personnel. Because the AICPA is a lobbying organization that reflects often controversial views of the "Big Eight" accounting firms, the participation of Federal employees on committees that attempt to influence the Federal Government is highly questionable. Federal employees affect Federal accounting practices through the performance of their official duties, and there is no need for them to participate in influencing other Federal employees through a professional lobbying organization.

The AICPA attempts to respond to major problems facing the accounting profession by proposing "reforms" that are acceptable to those controlling the organization. When strong criticism arose concerning failures in the establishment of accounting standards, the AICPA appointed a study commission which issued its report in March, 1972. That report recommended creation of the Financial Accounting Standards Board. Adoption of that recommendation resulted in the present inadequate system of establishing accounting standards which is described in this study.

Similarly, the AICPA appointed its Commission on Auditors' Responsibilities—the Cohen commission—to respond to criticism of independent auditors of major corporations arising from recent disclo-

sures of unreported corporate wrongdoing. Although the Cohen commission was established and is completely funded by the AICPA, it has been designated as an "independent" commission in an effort to boost its credibility. The AICPA's Cohen commission has not yet completed its study, but has given indications that it will support the concept of limited auditor responsibility advocated by the AICPA and the "Big Eight" accounting firms.

The AICPA has already adopted a voluntary program intended to assure the public regarding the quality of accounting firms practicing before the SEC. The primary participants in the program would be the "Big Eight" firms which would review each other to evaluate their quality control procedures. The program has several major deficiencies which make it wholly inadequate as a basis for public confidence in the quality of practice by large accounting firms.

Two proposals have been issued by the AICPA concerning an independent auditor's responsibility to detect and report illegal acts by clients. Both proposals are aimed at limiting the responsibility of independent auditors. The tone of the AICPA proposals is typified by a remarkable statement in the second one that auditors are not responsible for reporting illegal acts to the proper government authorities: "Deciding whether there is a need to notify outside parties of an illegal act is the responsibility of management. In the ordinary case, the auditor is under no legal obligation to notify outside parties."

The AICPA established the Financial Accounting Standards Board and plays a key role in selecting its members and financing its operation. AICPA control over the FASB is carefully written into the charter and bylaws creating the FASB. Chart 3 on page 137 illustrates the manner in which the AICPA controls the FASB.

Congress and the public should recognize the partisan and political nature of the AICPA when evaluating its influence on accounting practices promulgated or approved by the Federal Government. Under the control of the "Big Eight" accounting firms, the AICPA sets auditing standards and maintains control over the setting of accounting standards which have substantial impact on the public and the Federal Government. Many other areas of public policy affecting accounting and business are controlled or heavily influenced by the AICPA.

THE FINANCIAL ACCOUNTING FOUNDATION

The Financial Accounting Foundation (FAF) is the non-profit corporation organized by the AICPA and co-sponsored by four other private interest groups to operate the Financial Accounting Standards Board (FASB), which sets accounting standards.* Those groups are the Financial Executives Institute, the National Association of Accountants, the American Accounting Association, and the Financial Analysts Federation. None of those private interest groups is suited to control the setting of accounting standards which affect the Federal Government and the public.

*The Securities Industry Association was added as the sixth sponsor of the FASB on October 1, 1976. Although added as a sponsoring group too late to be included in this study, the Securities Industry Association reportedly represents the interests of more than 500 investment banking firms. Its addition as an FASB sponsor does not significantly affect the findings of this study.

As shown in Chart 1 on page 3 the FAF does not set accounting standards directly, but rather serves as an intermediate organization theoretically to separate the FASB from its private sponsors. That separation is the basis for the FASB's claim that it is "independent." Chart 3 on page 137 illustrates in more detail the relationship between the FASB organization and its private sponsoring groups. Chapters V, VI, VII, and VIII of this study describe the FASB organization, its sponsors, and its activities.

The FAF is comprised of nine trustees who are selected from the five sponsoring groups in the manner summarized on Chart 3. The AICPA maintains control over the FAF board of trustees because the exclusive power to elect and remove them is vested in the AICPA's board of directors, whose chairman is automatically designated as one of the trustees. The other sponsors only have the authority to nominate a single trustee each.

Eight of the nine FAF trustees are AICPA members. Only one of the trustees supposedly representing the other four sponsoring groups is not also a member of the AICPA. In addition to the control they exercise through the AICPA over the selection of all trustees, the "Big Eight" had three representatives serving directly as FAF trustees in 1976.

The board of trustees has two principal responsibilities—to appoint members of the FASB and the Financial Accounting Standards Advisory Council (FASAC), and to arrange for financing of the entire FASB organization. That organization is comprised of the FAF, the FASB, and the FASAC.

Exclusive authority to appoint and remove FASB members is vested in the FAF board of trustees, who cannot themselves simultaneously serve on the FASB. FASB members can be removed for "reasonably evidencing conduct detrimental to the purposes or repute of the FASB." Thus, FASB members are not truly independent of the trustees once they are appointed to office. The trustees themselves can be removed by the AICPA's board of directors for conduct "detrimental to the purposes or repute of the FAF or the FASB," so they are not truly independent either.

Financing for the FASB organization comes almost exclusively from its five private sponsoring groups and their members. All of the groups have pledged to support the FASB financially, but their contributions are not equal. Contributions to the FASB are concentrated among the large accounting firms and major corporations which would be most affected by any major reform of accounting standards.

The accounting profession donates about half of the money contributed to operate the FASB. In 1975, a total of $4,129,201 was contributed to operate the FASB, and the accounting profession donated $2,059,076. The "Big Eight", the AICPA, and 41 other accounting firms donated 99.6 percent of that amount.

The "Big Eight" firms each contribute $200,000 annually, so they accounted for $1.6 million or 78 percent of the $2,059,076 donated by the accounting profession in 1975. The next seven largest accounting firms contributed a total of $286,500, meaning that the Nation's 15 largest accounting firms gave a combined total of $1,886,500 or 92 percent of the contributions received by the FASB from the accounting

profession. The AICPA, which is controlled by the large accounting firms, donated most of the remainder.

Corporate contributions toward operating the FASB amounted to $1,928,349 in 1975, a little less than half of the total $4,129,201 received. Approximately 80 percent of the corporate contributions was traceable to members of the Financial Executives Institute, a business lobbying group, which is one of the FASB's sponsors. Although 1,397 corporations made contributions in 1975, 580 of the Nation's largest corporations donated 91 percent of the $1,928,349 designated by the FASB as coming from the corporate sector.

Contributions from the other FASB sponsors were much smaller. The National Association of Accountants, another organization representing business interests, contributed $75,000 in 1975. The American Accounting Association, which primarily represents academic accountants, donated only $6,876. The Financial Analysts Federation contributed $7,000.

Contributions for operating the FASB are made to the FAF which, after deducting its small operating expenses, passes the money to the FASB. That procedure is intended to create an impression that the FASB is insulated from the monetary influence of its sponsors. Donations to the FAF are tax-deductible, so the taxpayer partially subsidizes operation of the FASB.

THE FINANCIAL ACCOUNTING STANDARDS BOARD

The Financial Accounting Standards Board is the private body within the accounting establishment which actually sets accounting standards. Chart 1 on page 3 shows that the FASB is separated from the AICPA and its other sponsors by the FAF. A more detailed summary of the FASB's relationship with its sponsors is shown in Chart 3 on page 137.

The FASB's organizational separation from the private interest groups sponsoring it is the basis for the claim that it establishes accounting standards "independently." However, the separation is one in name only. This study finds that the "Big Eight" accounting firms, the AICPA and, to a lesser extent, the other sponsoring groups have control over the operation of the FASB. Such control is exercised in terms of money, personnel, and organizational support.

The FASB has seven members, and all of them belong to one or more of the five sponsoring groups. Six of the seven FASB members belong to the AICPA. In 1976, three of the members were from "Big Eight" firms.

Overall, 23 of the 32 FASB professional staff members belong to the AICPA. Ten of the 32 staff members were previously with "Big Eight" accounting firms. The concentration of FASB staff members identified with the AICPA and the "Big Eight" firms is greater in the higher staff positions and the positions which have the most impact on the accounting standards issued by the FASB.

There is a close identity between the leadership of the AICPA and the leadership in the FASB organization. The present FASB chairman is a past president of the AICPA. Even the Financial Accounting Standards Advisory Council, which is supposed to provide the FASB with a broad spectrum of outside advice, is largely comprised

of representatives from the same group of big accounting firms, big investment firms, big law firms, and big corporations which dominate every facet of FASB activity.

As part of its claim to independent operation in the public interest, the FASB has developed rules of procedure for promulgating accounting standards. Those rules generally permit an opportunity for critical comment on FASB proposals before they are finally adopted as standards. However, they do not overcome the fact that the FASB and its staff are not fairly balanced as to the interests represented by those persons who perform the work and make the actual decisions regarding accounting standards which affect the Federal Government and the public.

An example of the special interest orientation found throughout the FASB is the composition of the task forces which perform much of the work in researching and developing FASB positions on particular accounting issues. The memberships of such task forces are largely comprised of outside representatives from large accounting firms, corporate clients of "Big Eight" firms, contributors to the FASB, large investment firms, and big banks. The FASB's extractive industries task force, which is attempting to develop uniform accounting standards for oil, gas, and mining companies, has 19 identifiable outside interests represented on its membership. Seventeen are easily identified as having an actual or potential financial interest in the type of accounting standards used by extractive industries.

The FASB has adopted conflict of interest policies "to establish to public satisfaction the independence and objectivity of those responsible for establishing and improving standards of financial accounting and reporting." Despite its recognition that even the appearance of a conflict of interest is enough to undermine public confidence, the FASB's policies permit its members and staff to own unlimited amounts of investments, such as publicly traded securities, which could cause conflicts of interest. Members do not even have to report an investment to the FAF trustees unless it is "material," which the annual reporting instructions define as $25,000 or more invested in a single company.

The complete inadequacy of the FASB's policies to prevent conflicts of interest is perhaps best illustrated by the recent departure of an FASB member from one of the "Big Eight" accounting firms who resigned prior to the end of his term in order to return to his firm. His resignation appears to violate an FASB rule prohibiting members from entering into formal or informal employment agreements while serving on the FASB. It seems doubtful that an FASB member would resign with an announcement of his intent to return to his previous business affiliation without some formal or informal agreement that he was wanted back and that there was an acceptable position for him. A "revolving door" arrangement between the FASB and the big accounting firms supporting it has apparently already begun.

A review of the FASB's activities confirms the finding of this study that there is no reason to expect the FASB to achieve serious reform by establishing a system of uniform and meaningful accounting standards. Such a system is needed to replace the present collection of flexible, alternative standards which have permitted the growth of "creative accounting" as an acceptable option to accurate financial

reporting. A study sponsored by the AICPA has listed 31 separate kinds of business transactions with an aggregate of 80 different accounting alternatives for reporting the transactions.

During its three-year existence, the FASB has issued 12 "Statements of Accounting Standards." Those standards have addressed accounting problems of varying significance, but they have not resolved such problems in a manner which results in meaningful, as well as uniform, treatment of specific business transactions. Two of the standards have permitted alternative accounting methods, and none of them has seriously threatened the accounting prerogatives of various special interest groups in the established business community.

The FASB has also engaged in a series of private meetings with representatives of large accounting firms and big business. Meetings have not been held with other segments of the public affected by the FASB's pronouncements because the FASB only seeks direct contact with "responsible representatives of groups having a capability to provide meaningful information and insight concerning the establishment of financial accounting standards." Despite its failure to seek divergent views and establish a system of uniform and meaningful accounting standards in the public interest, the FASB and its sponsors launched an intensive lobbying campaign to thwart efforts by Congress to direct the SEC to establish such accounting standards for oil and gas companies.

THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission is the Federal Government's major participant in the accounting establishment. To an astounding degree, the SEC has permitted, and even insisted upon, establishment of accounting standards which have substantial impact on the Federal Government and the public by self-interested private accounting organizations. The result has been an extraordinary delegation of public authority and responsibility to narrow private interests.

Chapter IX of this study describes the accounting responsibilities of the SEC. The SEC's role in the present system of setting accounting standards is illustrated by Chart 1 on page 3.

In the Securities Act of 1933 and the Securities Exchange Act of 1934, Congress directed the SEC to protect the public from false and misleading information by requiring publicly-owned corporations to disclose financial and other information in a manner which accurately depicts the results of corporate activities. Congress gave the SEC broad authority to establish accounting and reporting standards as part of its mandate to administer and enforce the provisions of the Federal securities laws. Soon after its creation, the SEC decided by a three to two vote not to exercise its authority to set accounting standards.

Instead, the SEC decided to rely on accounting standards established in the private sector as being protective of the public interest, as long as such standards have "substantial authoritative support." During the ensuing 40 years, the AICPA has created three bodies to provide such support through authoritative pronouncements. A collection of flexible, alternative accounting standards—called generally accepted account-

ing principles—has evolved in the private sector to satisfy the SEC's "substantial authoritative support" test.

After the failure of its previous two standard-setting bodies to develop a system of uniform and meaningful accounting standards, the AICPA created the FASB in 1972 in an effort to stem criticism of its capability to set responsive standards. The SEC issued a policy statement—Accounting Series Release (ASR) 150—in 1973 which specifically endorses the FASB as the only private body whose standards will be recognized by the SEC as satisfying the requirements of the Federal securities laws. In effect, the SEC has delegated the establishment of accounting standards which are binding on all publicly-owned corporations to the special interest groups which control the FASB, and has reserved a mere oversight role for itself.

Far from being unhappy with the private sector's failure to establish uniform and meaningful accounting standards, the SEC has consistently defended its delegation of authority to standard-setting bodies controlled by the AICPA. In ASR 150, it said: "The determinations by these bodies have been regarded by the Commission, with minor exceptions, as being responsive to the needs of investors." That assured statement was made after the conglomerate takeovers of the 1960s, the unanticipated collapse of the Penn Central, and many other problems illustrating failures of accounting standards.

When Congress attempted to achieve uniform accounting standards for oil and gas companies in 1975 by directing the SEC to exercise its authority to set such standards, the SEC joined with the AICPA, the FASB, and other private interest groups in opposing the attempt. It undertook an intensive lobbying campaign in a successful effort to preserve its delegation of standard-setting authority. The SEC demonstrated more concern for protecting the FASB's privileged position than for protecting the public from misleading financial information.

Through the years, the SEC has maintained a close relationship with the AICPA and its standard-setting bodies. The SEC's chief accountants, who greatly influence its accounting policies, have belonged to the AICPA and worked with its committees intended to influence the SEC. One was even hired by the AICPA as a consultant at an annual rate of $60,000 after his retirement from the SEC.

The SEC has also shown a tendency to treat large accounting firms more leniently than individual CPAs and small firms in disciplinary actions. Individual CPAs and small firms are routinely suspended from practice before the SEC and identified publicly as punishment for their improper or illegal acts. The three "Big Eight" firms disciplined by the SEC for similar acts have received relatively mild sanctions, and the individuals involved were not identified publicly.

Auditing standards established by the AICPA are recognized by the SEC as adequate to assure the accuracy and reliability of corporate records supporting information reported to the public. Continual revelations of unreported corporate wrongdoing have raised serious questions regarding the adequacy of present auditing standards. The SEC has no procedures for checking the quality of work by independent auditors in performing their responsibilities under the Federal securities laws.

Arthur Andersen & Co., one of the "Big Eight" firms, has brought suit in Federal court to abrogate the SEC's policy of approving past

and future standards issued by the FASB. Preliminary findings by the court indicate that Congress will have to exercise its authority to correct the adverse effects of the SEC's delegation of standard-setting authority. Action by Congress will also be necessary to restore the opportunity for individuals to sue negligent accountants for damages under the Federal securities laws.

THE "BIG EIGHT" ACCOUNTING FIRMS AND THEIR CORPORATE CLIENTS

The last box in Chart 1 on page 3 illustrates the circular pattern of self-interest evident in the present system of setting accounting standards. The controlling influence of the "Big Eight" accounting firms in establishing accounting standards ultimately benefits the managements of their corporate clients by assuring that such standards will be generally acceptable to them. The "Big Eight" firms benefit because the present system enhances the value of their services to clients by permitting more flexibility in reporting financial results to the Federal Government and the public.

Unfortunately, accounting standards which permit corporate managements great flexibility in reporting the results of their business activities have resulted in many cases of inaccurate or misleading financial statements. Economic decisions based on such financial statements have caused substantial losses to investors, creditors, suppliers, purchasers and others. To the extent that public policies have been based on inaccurate or misleading financial statements, the Federal Government has acted upon illusion rather than fact.

For example, most Federal revenues are received from taxes computed on income or asset values. Accounting standards are instrumental in determining such income and asset values. Under the present collection of accounting standards, a business can report healthy earnings or severe losses merely by selecting alternative accounting standards. Accounting issues involve social issues such as the fair distribution of Federal taxation.

The FASB represents only the interests of its private sponsoring groups. No amount of transferring funds and authority through intermediate organizations can alter the fact that, in the end, all of the organizations are controlled by the same self-interested parties. The inability to divorce private influence from private control impairs all efforts to achieve public confidence in a system which vests public authority in private organizations.

Allegations of government inefficiency and wastefulness have been used to justify retention of the authority to establish accounting standards within the private sector. Available evidence, however, indicates that government agencies are capable of setting standards competently and more efficiently than private organizations. In any event, establishing accounting standards involves social issues that can be resolved effectively only by authorities responsible solely to the public.

Congress established the Cost Accounting Standards Board in 1970 "to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts." The CASB performs a standard-setting function

essentially similar to that performed by the FASB, but the CASB's staff and budget are approximately half the size of the FASB's. Although there are some deficiencies in the CASB's structure and procedures, it is performing its task competently overall. The CASB is described in Chapter X of this study.

Chapter XI of this study references some materials describing problems which have occurred because of improper or ineffective accounting and auditing practices. They demonstrate the need for accounting and auditing reforms. They also illustrate that accounting issues are information issues, involving the meaning, clarity, and amount of information given to Congress and the public regarding the activities of major corporations.

This study shows that there are serious deficiencies in the existing accounting establishment. The Federal Government, through the SEC, has cooperated in permitting the use of accounting practices which have resulted in substantial damage to the public in apparent violation of the intent expressed by Congress in the Federal securities laws. Reforms are needed to restore public confidence in the accuracy and reliability of financial and other information reported by publicly-owned corporations.

Recommendations

The Federal Government has an important responsibility to ensure that publicly-owned corporations are properly accountable to the public. Existing accounting practices promulgated or approved by the Federal Government have failed to fulfill that responsibility adequately. The following recommendations are based on the findings of this study, and identify actions which should be taken by Congress and appropriate Federal agencies in order to achieve efficient and effective accounting practices that will promote corporate accountability.

1. Congress should exercise stronger oversight of accounting practices promulgated or approved by the Federal Government, and more leadership in establishing proper goals and policies. Broad delegation of legislative authority to Federal agencies, which have in turn delegated broad authority to private interest groups, has been a major factor in the establishment of accounting practices which have benefitted special interests at the expense of the Federal Government and the public. As the branch of the Federal Government most directly representative of the public, Congress should exercise its authority to achieve proper accounting practices.

2. Congress should establish comprehensive accounting objectives for the Federal Government to guide agencies and departments in performing their responsibilities. The lack of such objectives has permitted divergent and sometimes contradictory accounting practices within the Federal Government. It has also contributed to the failure to establish uniform and meaningful accounting standards for publicly-owned corporations during the past 40 years.

The Cost Accounting Standards Board has benefitted from its specific statutory mandate to achieve "uniformity and consistency" in cost accounting standards used by the Federal Government, whereas the SEC has never established meaningful objectives for financial account-

ing standards. A comprehensive set of Federal accounting objectives should encompass such goals as uniformity, consistency, clarity, accuracy, simplicity, meaningful presentation, and fairness in application. In addition, Congress should establish specific policies abolishing such "creative accounting" techniques as percentage of completion income recognition, inflation accounting, "normalized" accounting, and other potentially misleading accounting methods.

3. Congress should amend the Federal securities laws to restore the right of damaged individuals to sue independent auditors for negligence under the fraud provisions of the securities laws. Such legislation is necessary to overturn the holding of the U.S. Supreme Court in *Ernst & Ernst* v. *Olga Hochfelder, et al.*, 96 Sup. Ct. 1375 (March 30, 1976) that "scienter"—the intent to deceive, manipulate, or defraud—is a necessary requirement of private actions for damages under the fraud provisions of the securities laws. The dissenting justices recommended that Congress restore the rights denied individuals in order to achieve the remedial intent of the Federal securities laws.

The few independent auditors who perform negligently should be held responsible for their actions, and should not be permitted to impair public confidence in the competence of all independent auditors. The Federal Government should not establish any "accountant-client privilege" or provisions which would limit the liability of independent auditors. Competent independent auditors already are adequately safeguarded, and unnecessary restrictions would impede the operations of Federal enforcement authorities and courts of law.

4. Congress should consider methods of increasing competition among accounting firms for selection as independent auditors for major corporations. At present, a single accounting firm, nominated by management, is placed on the ballot of annual meetings of stockholders. Domination of the corporate election process by large institutional investors and management ensures that the accounting firm nominated by management is elected. Long association between a corporation and an accounting firm may lead to such close identification of the accounting firm with the interests of its client's management that truly independent action by the accounting firm becomes difficult.

One alternative is mandatory change of accountants after a given period of years, or after any finding by the SEC that the accounting firm failed to exercise independent action to protect investors and the public. Another alternative is amendment of the Federal securities laws to require that more than one accounting firm be on the ballot at annual meetings of stockholders. The mechanism for achieving this choice for stockholders could be a requirement that stockholders with voting rights to a given, small percentage of the stock would be entitled to nominate an accounting firm as the independent auditor. Holders of a limited number of shares also could be permitted to vote for their own representative on a corporation's audit committee.

5. The Federal Government should directly establish financial accounting standards for publicly-owned corporations. Accounting standards involve social and economic issues which can only be resolved effectively through the processes of government responsible solely to the public. Furthermore, all segments of the public affected

by accounting standards should be represented in the decision-making process.

As intended by Congress in the Federal securities laws, the SEC provides a public forum for setting accounting standards through its rule-making procedures. However, the SEC's long association with the private accounting establishment and insistent determination to rely upon its accounting pronouncements cast substantial doubt on the SEC's ability to establish accounting standards which would restore public confidence in corporate financial reporting.

Other alternatives would be to establish financial accounting standards through a Federal board similar in operation to the CASB or establishment of accounting standards by the General Accounting Office. Public participation and strong oversight by Congress are essential to safeguarding the public interest in any standard-setting procedure adopted.

6. The Federal Government should establish auditing standards used by independent auditors to certify the accuracy of corporate financial statements and supporting records. Again, participation by all segments of the public is necessary to develop auditing standards that will restore public confidence in the integrity of corporate reports. In view of the substantial record of previously unreported corporate wrongdoing which has been revealed during the past few years, a special review of present auditing standards should be undertaken to determine their adequacy prior to considering their adoption by the Federal Government. Auditing standards could be established by the General Accounting Office, the SEC, or by Federal statute.

7. The Federal Government should itself periodically inspect the work of independent auditors for publicly-owned corporations. Such a mandatory inspection program should be designed to provide assurance to the public and Congress that independent auditors are performing their responsibilities competently in accordance with proper standards of conduct. Periodic quality reviews could be conducted by the General Accounting Office, the SEC, or a special audit inspection agency.

8. The Federal Government should restore public confidence in the actual independence of auditors who certify the accuracy of corporate financial statements under the Federal securities laws by promulgating and enforcing strict standards of conduct for such auditors. Those standards should specifically prohibit activities by auditors which impair their independence in fact or appearance. Direct or indirect representation of clients' interests and performance of non-accounting management advisory services for public or private clients are two activities which are particularly incompatible with the responsibilties of independent auditors, and should be prohibited by Federal standards of conduct.

The SEC is the appropriate agency to promulgate and enforce standards of conduct under its authority to determine the qualifications of independent auditors.

9. The Federal Government should require the Nation's 15 largest accounting firms to report basic operational and financial data annually. Those firms operate as partnerships and are not required to report such information to the public, but they perform public responsibilities as independent auditors for the vast majority of the Nation's

sizable publicly-owned corporations. Congress and the public need basic information on the organization, activities and financial status of the 15 largest accounting firms in order to evaluate their performance of important public responsibilities under the Federal securities laws.

The subcommittee collected certain basic information on the "Big Eight" accounting firms, but this study finds that there is a need for more comprehensive information to be collected by the Federal Government on an annual basis. Such information should clearly disclose the financial position, operations, and various activities of large accounting firms. The appropriate Federal agency to collect such information is the SEC.

10. The Federal Government should define the responsibilities of independent auditors so that they clearly meet the expectations of Congress, the public, and courts of law. Independent certification concerning the accuracy of corporate records and the fair presentation of financial information is essential to successfully protecting the public through adequate disclosure of corporate activities, as intended by Congress in the Federal securities laws. The independent auditor's certification included in corporate reports should be understood by all auditors to mean that financial information is presented fairly and that corporate records are complete and accurate.

Independent audits that do not ensure fairness and accuracy are useless as a basis for public reliance upon information disclosed by publicly-owned corporations. Limited responsibility audits that provide only vague indications of fairness and accuracy, which are advocated by certain segments of the accounting establishment, result in substantial costs without achieving the assurance necessary to make the present disclosure system operate effectively. If independent auditors cannot provide proper certification of information reported by publicly-owned corporations, then the Federal Government should seek alternative methods of performing that necessary function.

11. The Federal Government should establish financial accounting standards, cost accounting standards, auditing standards and other accounting practices in meetings open to the public. Accounting practices involve broad social and economic issues which should not be decided in private, and do not qualify as exemptions under Federal statutes regarding open meetings.

12. The Federal Government should act to relieve excessive concentration in the supply of auditing and accounting services to major publicly-owned corporations. The Department of Justice and the Federal Trade Commission should investigate and determine whether violations of the Federal antitrust laws have resulted from excessive concentration in the supply of such services among all industries or within specific industries. Congress should consider other methods of reducing concentration in the supply of auditing and accounting services to major corporations.

13. The Federal Government should retain accounting firms which act as independent auditors only to perform auditing and accounting services. The Federal Government should not contract with such firms for the performance of management advisory services or other con-

sulting services which are incompatible with the responsibilities of independent auditors.

14. The Securities and Exchange Commission should treat all independent auditors equally in disciplinary and enforcement proceedings under the Federal securities laws. Large accounting firms and their partners should receive the same sanctions as individual CPAs and small firms for similar offenses. The SEC and other Federal agencies should not rely on private parties and organizations to conduct compliance reviews ordered as a result of disciplinary or enforcement proceedings, but should conduct such reviews themselves. Public confidence in the enforcement of Federal statutes and regulations is impaired when public responsibility is delegated to private parties and organizations which may be self-interested.

15. The membership of the Cost Accounting Standards Board should not be dominated by representatives of industry and accounting firms which may have vested interests in the standards established by the board. By statute, industry is guaranteed one position on the five-member CASB, and the remaining two appointed members from the private sector should be independent of real or potential conflicts of interest. The appointed member from the Federal Government should be rotated among the many Federal departments and agencies affected by CASB standards, and should not always represent the Department of Defense.

16. Federal employees should not serve on committees of the American Institute of Certified Public Accountants or similar organizations that are assigned to directly or indirectly influence accounting policies and procedures of the Federal Government. Federal employees should remain free from the appearance of conflicts of interest regarding the fair and objective performance of their public duties.

CHAPTER I. THE "BIG EIGHT" ACCOUNTING FIRMS

Introduction

The accounting profession is dominated by eight giant accounting firms, collectively known within the business and financial community as the "Big Eight." The "Big Eight" are so large and influential in relation to other CPA firms that they are able to control virtually all aspects of accounting and auditing in the United States.

Listed alphabetically, the names and addresses of the "Big Eight" accounting firms are as follows:

Arthur Andersen & Co., 69 West Washington Street, Chicago, Illinois 60602.

Arthur Young & Co., 277 Park Avenue, New York, New York 10017.

Coopers & Lybrand, 1251 Avenue of the Americas, New York, New York 10020.

Ernst & Ernst, 1300 Union Commerce Building, Cleveland, Ohio 44115.

Haskins & Sells, 1114 Avenue of the Americas, New York, New York 10036.

Peat, Marwick, Mitchell & Co., 345 Park Avenue, New York, New York 10022.

Price Waterhouse & Co., 1251 Avenue of the Americas, New York, New York 10020.

Touche Ross & Co., 1633 Broadway, New York, New York 10019.

The "Big Eight" firms exercise influence far beyond that which is indicated by the number of CPAs they employ, or the number of clients they audit. For example, the American Institute of Certified Public Accountants (AICPA)* estimates there were 150,000 to 160,000 CPAs licensed to practice in the United States at the end of 1975. About 118,000 CPAs are members of the AICPA. Of that number, approximately 17,400 or 15 percent of the AICPA members are associated with the "Big Eight" accounting firms. Thus, the "Big Eight" firms have only 11 or 12 percent of the Nation's CPAs working for them.

The source of the tremendous influence wielded by the "Big Eight" accounting firms is related to the size and influence of their clients, rather than to the number of individual accountants associated with these firms. The vast majority of large corporations, which control the bulk of the Nation's business wealth, employ one of the "Big Eight" firms as their independent auditor. Fees for accounting services are related to the size of the business for which such services are performed. Thus, big clients provide the "Big Eight" with the opportunity to earn big accounting fees.

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*The AICPA is the largest and most prestigious professional organization representing the interests of CPAs. The manner in which the AICPA is dominated by the "Big Eight" is described fully in subsequent sections of this study.

The amount of wealth received by the "Big Eight" firms through fees for their services is to some extent proportionate to the amount of economic wealth controlled by their clients. Since their clients control a large proportion of the Nation's economic wealth, the "Big Eight" accounting firms receive the substantial accounting fees associated with that wealth. Revenues generated by the practice of accounting in the United States are concentrated among the "Big Eight" accounting firms in the same way that the Nation's economic wealth is concentrated among their clients.

There are three distinct methods by which the "Big Eight" firms are able to use their wealth and position to influence economic and social events in the United States. As will be shown throughout this study, the "Big Eight" accounting firms actively use all three methods to promote their interests.

(1) "Big Eight" firms are able to exercise substantial influence directly because of their size and their considerable financial resources. Apart from their partners and principals, they collectively employ over 48,000 people. The "Big Eight" accounting firms had estimated total gross revenues of over $2 billion in 1975, with net earnings approximating more than $500 million. The total employment and financial resources directly controlled by the "Big Eight" are very substantial, but there is an unequal distribution of those resources among them because the eight firms are of differing sizes.

(2) The influence of the "Big Eight" firms is also exercised through independent organizations. As described subsequently, the AICPA is so thoroughly dominated by the "Big Eight" firms that it has become a conduit for collectively expressing their views and promoting their interests. The American Accounting Association is also influenced by the "Big Eight" firms through financial support and individual membership. Thus, the "Big Eight" are able to use their influence to affect the activities of independent organizations, and avoid the appearance of directly promoting their own interests.

(3) Finally, the "Big Eight" are able to exercise substantial influence indirectly through their clients. Decisions made by these firms on auditing and accounting matters have an important impact on the economic and social activities of their clients. The large corporate clients of the "Big Eight" heavily influence the economy, as well as society in general. Accounting is the language by which businesses report the results of their activities, and the "Big Eight's" dominion over the language of accounting used by their clients is a source of great influence for these firms.

The "Big Eight" accounting firms perform a variety of management advisory services in addition to tax advice, auditing, and other accounting services. Management advisory services offered by them include executive recruitment, product and market analysis, plant layout, actuarial services, and financial management services. All of the "Big Eight" firms employ specialists who are not CPAs to increase their expertise in the performance of management advisory services. The "Big Eight" are much more than just accounting firms.

There are many basic similarities among the "Big Eight" accounting firms, and they are often grouped together for the purpose of describing their activities. While it is useful to describe the activities of the "Big Eight" firms as a group, they are not equal in all respects.

They do not all offer exactly the same services, and their clients are not all of the same size or quality. In terms of annual revenues, the "Big Eight" accounting firms are of varying sizes, probably ranging from less than $200 million to more than $500 million for individual firms. Analysis of the information collected by this subcommittee illustrates some of the differences, as well as the similarities, among the "Big Eight" firms.

Because of their extensive influence and their roles as the independent auditors for the Nation's largest corporations, the "Big Eight" accounting firms have a great impact on accounting practices which are promulgated or approved by the Federal Government. Their broad range of political activities and management advisory services also affect policies and programs of the Federal Government. Thus, Congress and the public must have knowledge of the "Big Eight" accounting firms and their activities in order to properly formulate Federal policies and accounting practices which are significantly affected by the "Big Eight" firms.

Subcommittee Requests for Information

This subcommittee began its present study of the relationship between the accounting profession and Federal accounting practices because there was a clear need for reliable information concerning the accounting profession and its activities. Unfortunately, reliable information on the accounting profession is not regularly available to Congress and the public because CPAs generally practice accounting as business partnerships. Business partnerships are not required to report publicly any information on their financial standing, or their activities. Unlike publicly-owned corporations, business partnerships may reveal to the public only such information as they desire.

Preliminary research and inquiries by the subcommittee staff to members of the accounting profession indicated that the only way for this subcommittee to obtain reliable information on the accounting profession would be to request such information directly from accounting firms themselves. Accordingly, a questionnaire requesting basic information on accounting firms was prepared and sent to each of the "Big Eight" accounting firms on December 19, 1975. (See Appendix A, p. 191.) The subcommittee sent its initial questionnaire only to the "Big Eight" firms because it was believed those firms would be able to provide this subcommittee with the bulk of the information needed to perform its study of Federal accounting practices.

The responses of the "Big Eight" firms to the subcommittee's December 19, 1975 questionnaire are included in Appendix A, p. 196. Although the information requested was basic descriptive data and did not involve disclosure of trade secrets, two of the "Big Eight" firms asked that their responses be kept confidential. Coopers & Lybrand requested partial confidentiality for its response, but "reluctantly" acquiesced when informed of the open responses by six other firms. (See Appendix A, p. 288.) Touche Ross & Co. originally asked that its entire response be kept confidential, but finally agreed to permit public use of all information except data relating to amounts of Federal contracts performed by the firm. (See Appendix A, p. 404.)

Information which cannot be disclosed to Members of Congress and the public is useless as a means of informing them about the sub-

stantial impact of major accounting firms on Federal accounting practices. This subcommittee cannot fulfill its responsibilities by collecting information needed by Congress and the public, and then refusing to make such information available to them. Information on Federal contract expenditures is not confidential, but the subcommittee granted the Touche Ross & Co. request in order to expedite completion of the initial phase of the subcommittee's study of Federal accounting practices.

This subcommittee sent two supplemental requests for information to the "Big Eight" accounting firms. By letter of 8 April, 1976, the subcommittee asked for copies of any testimony or presentations by each "Big Eight" firm before Congress, a State legislature, or a Federal or State regulatory commission since 1 January, 1975. (See Appendix C, p. 569.) All of the "Big Eight" firms cooperated in providing that information, although a few firms did not respond completely.

The subcommittee's request for public testimony and presentations covered a time span of only 15 months. However, the subcommittee received a large volume of materials in response to its request due to abundant activity by "Big Eight" firms in this area. The subcommittee staff has reviewed all of the materials submitted, and some examples of the materials received are included in Appendix C. They are described and referenced subsequently in this study.

The last subcommittee request for information from the "Big Eight" was by letter of 7 June, 1976. (See Appendix D, page 845.) That letter asked for data on the annual compensation received by each of the three highest paid individuals in each firm, and the number of women and blacks who are partners of each firm. As subsequently described in this document, certain Federal agencies rely on private organizations dominated by the "Big Eight" firms to perform important public responsibilities assigned to those agencies. Congress and the public need to know the financial interests of private groups which perform public responsibilities assigned to Federal agencies. They must also know whether such private groups adequately represent all sectors of the public.

Only Arthur Andersen & Co. and Price Waterhouse & Co. responded completely to the subcommittee's 7 June, 1976 request. Five of the remaining firms refused to provide information on the compensation earned by their three highest paid partners, but did provide information on their number of women and black partners. Touche Ross & Co. refused to provide any information at all. The responses of the "Big Eight" firms are included in Appendix D beginning on page 847.

One of the primary functions of this study is to provide a ready source of information to Congress and the public on the relationship between the accounting profession and the Federal Government. Much of this information has been unavailable previously to either Congress or the public. This subcommittee has used its resources to collect some basic information on major accounting firms which should be publicly available.

Part of the data used in this study included information on other major accounting firms in addition to the "Big Eight" firms. Some sections of this document provide information on the next seven largest accounting firms after the "Big Eight." Those seven firms

are placed by the AICPA in the largest-size category for its advisory committees, along with "Big Eight" firms. The 15 largest accounting firms in the Nation are a useful and reasonably complete grouping for purposes of measuring the influence of major accounting firms on the Federal Government.

At times, this study will refer to the next seven largest accounting firms in the Nation after the "Big Eight" firms. Listed alphabetically, the names and addresses of the next seven largest accounting firms are as follows:

Alexander Grant & Co., 1185 Avenue of the Americas, New York, New York, 10036.

Hurdman and Cranstoun, 140 Broadway, New York, New York 10005.

J. K. Lasser & Co., 10 East 53rd Street, New York, New York 10022.

Laventhol & Horwath, 919 Third Avenue, New York, New York 10017.

S. D. Leidesdorf & Co., 100 East 42nd Street, New York, New York 10017.

Main Lafrentz & Co., 280 Park Avenue, New York, New York 10017.

Seidman & Seidman, 15 Columbus Circle, New York, New York 10023.

Other Information on the "Big Eight" Accounting Firms

The subcommittee has also received information concerning the activities of "Big Eight" firms from sources other than the "Big Eight" themselves. Information was requested from the AICPA, the Financial Accounting Standards Board (FASB) and its private sponsoring groups, certain Federal agencies, and various other public and private sources. A major portion of that information is included in this study, and is described and referenced in subsequent sections.

The subcommittee staff has held numerous discussions with representatives of "Big Eight" firms, members of other accounting firms, Federal officials, and representatives of the AICPA and the FASB. Many articles, newspaper reports, public statements, and government reports have been reviewed. Unsolicited information has also been received by the subcommittee.

Arthur Andersen & Co. has published an annual report for the past three years giving some detail on its activities. The information reported by Arthur Andersen & Co. is intended to promote the firm's own interests, and is not verified by any outside sources. Allowing for those limitations, however, the Arthur Andersen & Co. annual report is a useful source of information on the activities of one "Big Eight" firm. It is also useful as a gauge for evaluating the information submitted by other "Big Eight" firms. Copies of the Arthur Andersen & Co. annual report may be obtained directly from that firm.

Size of the "Big Eight" Accounting Firms

The subcommittee has condensed much of the information it collected from the "Big Eight" firms into Table I on page 30. The table facilitates comparisons among the firms and illustrates their substantial size, both individually and collectively.

TABLE I.—SUMMARY OF CERTAIN INFORMATION CONTAINED IN RESPONSES OF THE "BIG EIGHT" ACCOUNTING FIRMS TO THE DECEMBER 19, 1975 QUESTIONNAIRE

	Arthur Andersen	Arthur Young	Coopers & Lybrand	Ernst & Ernst	Haskins & Sells	Peat, Marwick, & Mitchell	Price Waterhouse	Touche Ross
1. Please state the number of offices which your firm maintains within the United States (if more than 1 partnership, corporation or other entity exists in the United States, please furnish all names and answer subsequent questions accordingly)	[1] 48	[2] 64	81	112	93	100	67	76
2. Please indicate the number of States, territories or possessions of the United States in which your firm maintains an office or affiliated office	[3] 31	[4] 35	36	45	40	[5] 45	[6] 33	37
3. Please state the number of cities outside the United States in which your firm maintains offices or has an affiliation	58	150	242	146	137	199	203	235
4. Please state the number of partners in your firm located in the United States (include only certified public accountants)	[7] 698	414	521	484	443	791	348	451
5. Please state the number of principals located in your offices in the United States who are not certified public accountants	[8] 65	50	44	20	[9] 12	90	[9] 18	33
6. Please state the total number of employees of your firm within the United States, excluding only partners and principals	8, 554	4, 800	6, 189	5, 795	4, 798	8, 227	5, 933	4, 219
7. Please indicate the approximate percentage of total revenues for services performed by your firm in the following categories:								
A. Auditing and accounting	66	69	69	73	74	68	76	62
B. Tax services	18	17	19	17	15	21	16	24
C. Management advisory services including executive recruitment, product analysis, marketing analysis, and plant layout	16	14	10	9	5	11	6	14
D. Actuarial services			2			[13] 1		[14]
E. Services performed for Federal, State or local governments	[10] 3	[11] 5–10	[12] 2	1	<5	4	2	[15]
F. Other					6			
8. Please state if your firm renders management or other advisory services in the following categories:								
A. Executive recruitment	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
B. Marketing analysis	No	[17]	[18] Yes	Yes	No	Yes	No	Yes
C. Plant layout	No	[17]	[18] Yes	Yes	No	Yes	No	Yes
D. Product analysis	No	[17]	No	Yes	No	Yes	No	Yes
E. Actuarial services	No	[17]	Yes	No	[19] No	Yes	No	[20]
F. Federal advisory committees	[16]	[17]	Yes	No	[19] No	Yes	No	[21]
11. Please state the number of other publicly held corporations for which your firm is the independent auditor, and the number of privately held corporations for which your firm is the independent auditor:								
(a) other publicly held corporations	[22]	[23] 430	561	[23] 700	369	745	523	380
(b) privately held corporations	[22]	[24] 1, 950	4, 877	[23] 9, 000	4, 798	22, 500	[25] 4, 787	1, 516
12. Please indicate the total number of partners, principals and employees of your firm who are members of the American Institute of Certified Public Accountants	2, 352	2, 140	2, 280	[26] 2, 730	1, 235	[27]	2, 200	[28] 1, 458
13. Please state if your firm has made financial contributions, directly or indirectly, to the Financial Accounting Standards Board. If so, please indicate the amount of contributions made annually to date (in thousands of dollars):								
A. 1972			90					
B. 1973	200	200	150	200	200	200	200	200
C. 1974	200	200	200	200	200	200	200	200
D. 1975	200	200	200	200	200	200	200	200

16. Please state your firm's annual gross revenue from services performed for Federal departments, agencies, subdivisions or authorities during each year from Jan. 1, 1970 to Dec. 31, 1975:[29]									
1970	(30)	$430,000	$532,000	$584,000	$185,000	(31)	$2,000	(15)	
1971	$528,000	$270,000	$757,000	$952,000	$540,000	$4,310,000	$52,000	(15)	
1972	$2,454,000	$1,320,000	$589,000	$1,533,000	$1,120,000	$3,540,000	$69,000	(15)	
1973	$1,772,000	$2,960,000	$1,063,000	$1,106,000	$1,165,000	$2,970,000	$258,000	(15)	
1974	$3,801,000	$4,010,000	$789,000	$701,000	$920,000	$3,250,000	$172,000	(15)	
1975	$1,197,000	$4,650,000	$1,473,000	$1,025,000	$1,160,000	$4,020,000	$1,320,000	(15)	
17. Please state if your firm maintains a department, division or office for the procurement of Federal, State, and local government contracts.	Yes	[32] Yes	[33] No	Yes	[34] No	No	Yes		No

[1] Excluding Puerto Rico.

[2] Including Puerto Rico.

[3] 30 States and Puerto Rico: 31 total.

[4] 33 States and the District of Columbia, and Puerto Rico: 35 total.

[5] 42 States and Guam, the District of Columbia, and Puerto Rico: 45 total.

[6] 32 States and Puerto Rico: 33 total.

[7] Arthur Andersen has 698 partners; 638 presently are on assignment in the United States and 60 normally assigned in the United States are temporarily assigned outside the United States.

[8] Arthur Andersen has 56 principals presently on assignment in the United States and 9 principals temporarily on assignment outside the United States: Total of 65.

[9] All management advisory service personnel.

[10] The 3 percent reported as services performed for Federal, State or local governments is included in the amounts reported in A, B, and C.

[11] Services performed for Federal, State and local governments amount to 5 to 10 percent of the total of A, B, and C.

[12] The 2 percent reported as services performed for Federal, State and local governments is included in the amounts reported in A, B, C, and D.

[13] The 1 percent reported as actuarial services and the 4 percent reported as services performed for Federal, State and local governments are included in the amounts reported in A, B, and C.

[14] Actuarial services performed by Touche Ross Stennes.

[15] Confidential at the request of Touche Ross & Co.

**[16] "F. Federal advisory committees individual members of our firm have served on several U.S. Federal advisory committees. Payments recieved for such individual activities and remitted to the firm have been insignificant in amount."

**[17] "Our firm renders services in executive recruitment. We have performed services in the areas of marketing analysis, product analysis and plant layout; however our work in these areas represents an insignificant portion of our management advisory services and is normally limited to fact gathering or is incidental to our work in other areas such as cost accounting and managerial control systems. We do not perform actuarial services, nor do we serve on Federal advisory committees."

[18] Services performed in marketing analysis and plant layout are minimal. At the present time, Mr. Frank Grey, a member of Coopers & Lybrand, is serving as a member of the SEC Advisory Committee on Real Estate.

**[19] "Actuarial services: Haskins & Sells does not provide what we consider to be 'actuarial services.' We do utilize actuarial skills as required in our auditing and accounting and accordingly any use of these skills is classified in our statistical records as auditing and accounting services. We estimate, however, that the revenue that might be related to use of these skills is a small fraction of 1 percent of our total revenue. Services for government entities: We perform auditing and accounting and management advisory services for governmental entities. Data regarding our services is normally classified in our statistical records by the nature of the services performed and not by the type of entity served. We estimate, however, that revenues from our services for Federal, State, and local governments amount to less than 5 percent of our total revenues."

[20] Actuarial services provided by Touche Ross Stennes.

**[21] "F. Only on a voluntary basis at no expense to the Government. At present, Mr. D. V. Burchfield, a partner, is serving on the General Services Administration Advisory Committee on Cash Management."

[22] Arthur Andersen states that it has 6,000 clients not listed on either the New York or American stock exchanges, it gives no breakdown of this figure for public and private corporations.

[23] Number given by firm is approximate.

[24] Figure includes only those private corporations which had annual fees over $7,500.

[25] Figure does not include nonprofit corporations or clients that are not corporations.

[26] AICPA membership: partners, 484; employees, 2,246; total, 2,730.

[27] AICPA membership not known by Peat, Marwick & Mitchell. Membership is on an individual basis.

[28] AICPA membership: partners, 442; employees, 1,016; total, 1,458.

[29] Each firm has reported revenues for 12-month periods, ending at various times. Reporting period for each firm as follows: Arthur Andersen: 12 months ending Mar. 31, (1970-74) Aug. 31, 1975; Arthur Young: 12 months ending Dec. 31; Coopers & Lybrand: 12 months ending Dec. 31; Ernst & Ernst: 12 months ending Dec. 31; Haskins & Sells: 12 months ending approximately May 31; Peat, Marwick & Mitchell: 12 months ending June 30; Price Waterhouse: 12 months ending June 30.

[30] Data for 12-month period ending Aug. 31, 1970, not submitted by Arthur Andersen.

[31] Data for 12-month period ending June 30, 1970, not submitted by Peat, Marwick & Mitchell.

**[32] "No specific division, department or office for obtaining government contracts. All offices may perform services under Federal, State or local government contracts. Arthur Young has 5 offices where services performed are predominantly under Government contracts."

**[33] "The firm does not maintain a department division or office for the procurement of Federal, State, and local government contracts, however, we do have certain persons who are involved in responding to Government RFP's."

**[34] "Haskins & Sells does not maintain a department, division or office for the procurement of Federal, State or local government contracts. Relationships with government entities are handled by the practice office responsible for performance of the services required. This means that the relationships with Federal entities are largely the responsibility of individuals in the Washington, D.C. office who have experience in Federal activities and tend to specialize in this aspect of the practice."

Note: Double asterisk denotes firm's full response to subcommittee.

The "Big Eight" firms all have strong national and international operations with many offices throughout the United States and the world. For example, Table I shows that the number of offices in the United States operated by "Big Eight" firms ranges from Arthur Andersen & Co.'s 48 offices in 31 States and territories to Ernst & Ernst's 112 offices in 45 States and territories. The average number of domestic offices operated by a "Big Eight" firm is 80 offices in 38 States and territories.

Each of the "Big Eight" firms maintains an extensive network of offices and affiliations outside the United States. As shown by Table I, the number of international offices and affiliations ranges from 58 for Arthur Andersen & Co. to 242 for Coopers & Lybrand. Four of the firms each have more than 100 international offices and affiliations.

The number of major corporations for which "Big Eight" firms serve as the independent auditor is also impressive. Of the 2,641 corporations listed on either the New York Stock Exchange or the American Stock Exchange in 1974, 2,248 or 85 percent are audited by one of the "Big Eight" accounting firms. (See Appendix B, p. 411.) In addition, Table I on page 30 shows that the "Big Eight" firms audit several thousand other publicly and privately owned businesses.

"Big Eight" firms have many partners and employ large staffs to perform services for their clients. In the United States, Price Waterhouse & Co. has the fewest partners (348), and Peat, Marwick, Mitchell & Co. has the most (791). Most of the firms have between 400 and 525 partners. Partners are responsible for the results of services performed by accounting firms.

Table I shows that Arthur Andersen & Co. has the largest staff (8,554). Touche Ross & Co. has the smallest staff (4,219). Excluding partners and principals, the "Big Eight" firms collectively employ a total of 48,515 people. The majority of employees are professional staff, and the remainder are clerical employees.

Considering that most CPAs practice accounting with fewer than 10 partners, the "Big Eight" accounting firms are truly giant organizations. With operations spanning the United States and the world, they are the counterpart in the field of accounting to the multinational corporations in the business field. The supply of accounting services for major international corporations is essentially concentrated among only the "Big Eight" accounting firms.

Services Offered by the "Big Eight" Accounting Firms

The "Big Eight" accounting firms offer a broad range of services to clients and potential clients. They offer services which have traditionally been performed by CPAs, as well as additional non-accounting services.

The responses of the "Big Eight" firms to information requests by this subcommittee provide some detail on the types of services they perform. Table I on page 30 shows the percentage of total revenues earned by each firm from the performance of specific services. The major categories of services performed by "Big Eight" firms are auditing and accounting services, tax services, and management advisory services.

AUDITING AND ACCOUNTING SERVICES

Auditing and accounting services involve designing a reliable system of recordkeeping for businesses, checking the recordkeeping system periodically to assure that it is effective, providing assistance in presenting financial information so that it accurately conveys the results of business activities, and certifying financial statements for accuracy. These are the basic services which have been performed traditionally by the accounting profession. The need for expertise in providing such services to businesses is the primary reason for the development of the accounting profession and the licensing of CPAs.

Enactment of the Federal securities laws in 1933 and 1934 amplified the need for effective auditing and accounting services by qualified independent accountants. Because their major clients are publicly-owned corporations, the "Big Eight" firms have been especially affected by the Federal securities laws. Auditing and accounting services performed by independent auditors under the Federal securities laws were intended to benefit the public, rather than the managements of the businesses being audited. The requirement that independent auditors be primarily responsible for protecting investors, creditors, and other third parties has created a special position in society for CPAs who choose to act as independent auditors. They are supposed to provide independent certification that publicly-owned corporations are accurately presenting the results of corporate activities.

Auditing and accounting services performed by "Big Eight" accounting firms for publicly-owned corporations are optimally beneficial to both corporate managements and outside parties, all of whom should be interested in having an accurate presentation of corporate financial results. Corporate managements should benefit by having accurate information for use in operating their businesses more efficiently. Outside parties, such as investors, creditors, and governmental authorities, should benefit because they may safely rely upon the independently audited information reported by corporations.

Performance of traditional auditing and accounting services as the independent auditors for the vast majority of the Nation's large corporations is the most important source of revenues for the "Big Eight" accounting firms. On the average, approximately 70 percent of the revenues received by a "Big Eight" firm results from performing auditing and accounting services. Price Waterhouse & Co. ranks highest in this regard, at 76 percent of total revenues, and Touche Ross & Co. ranks the lowest, at 62 percent of total revenues.

TAX SERVICES

Tax services are another important source of revenues for CPAs. The "Big Eight" firms average about 18 percent of their total revenues from the performance of tax services.

Touche Ross & Co. derives the highest proportion of total revenues from performing tax services (24 percent). Haskins & Sells ranks lowest in this comparison, deriving 15 percent of total revenues from tax services.

The performance of tax services has grown more important as a revenue source because tax provisions at the Federal, State and local levels

have become more complex during the past 25 years. As governments increasingly have used tax laws to achieve economic and social goals, expertise in tailoring business operations to maximize the benefits available under the tax laws has become a valuable financial resource to businesses.

MANAGEMENT ADVISORY SERVICES

Performance of management advisory services has also become an important source of revenues for the "Big Eight" accounting firms. The relative importance of management advisory services to revenues ranges from 5 percent of total revenues for Haskins & Sells to 16 percent of revenues for Arthur Andersen & Co. The average for the firms is about 11 percent of total revenues.

All of the "Big Eight" accounting firms employ specialists who are not CPAs to perform management advisory services. Many of the senior specialists have become "principals" in the "Big Eight" accounting firms. Only CPAs may legally become partners in a CPA firm, but the "principals" who are not CPAs enjoy most of the same benefits as the partners in "Big Eight" firms.

Table I on page 30 shows that the number of "principals" employed by a "Big Eight" firm tends to parallel the proportion of total revenues derived from performing management advisory services. Haskins & Sells has only 12 "principals" who are not CPAs, but Arthur Andersen & Co. has 65, and Peat, Marwick, Mitchell & Co. has 90 "principals." The "Big Eight" firms collectively employ a total of 332 "principals" who occupy senior positions within the firms, but are not CPAs.

This subcommittee asked each of the "Big Eight" firms if it provided certain specified types of management advisory services. The firms' responses are summarized in Table I. Arthur Andersen & Co. performs a substantial amount of management advisory services, but does not perform any of the services specified by the subcommittee in its questionnaire. The following is a brief description of the primary types of management advisory services performed by large accounting firms, along with the number of "Big Eight" firms that provide each service.

Executive Recruitment.—All of the "Big Eight" firms except Arthur Andersen & Co. provide executive recruitment services. This service involves either finding a new executive to satisfy a client's particular needs, or finding a suitable position at another company for an executive who is no longer needed by a client.

The "Big Eight" firms are generally involved with recruiting high-level executives to occupy senior management positions. Because of their broad range of business connections and their reputations as auditors for providing expert financial services, the "Big Eight" firms are a natural source of inquiry for clients seeking important executives. The "Big Eight" firms have capitalized on their position of influence by marketing executive recruitment services.

Marketing Analysis.—Marketing analysis involves performing studies to determine the feasibility of selling a client's products or services to a particular market. This service may include identifying likely customers, surveying the attitudes of consumers, or finding

areas of excess disposable income. Four of the "Big Eight" firms provide marketing analysis services.

Plant Layout.—Plant layout services involve organizing clients' plant facilities to maximize their productive capabilities. This service includes providing expertise in efficiently organizing physical plants, as well as recognizing the best ways to maximize employee resources within a plant complex. Four of the "Big Eight" firms provide plant layout services.

Product Analysis.—This service involves analyzing a client's product to determine its value to customers who may be interested in purchasing the product. Three of the "Big Eight" firms provide product analysis services.

Actuarial Services.—Actuarial services involve forecasting how much money must be contributed from a client's earnings each year to fund its pension program on a sound financial basis. Client companies with pension plans for their employees are required to fund their pension programs over a number of years on a financially sound basis. Actuarial services are provided by three of the "Big Eight" firms that have acquired actuarial firms through mergers.

Financial Management Services.—Although this subcommittee did not ask the "Big Eight" firms in its questionnaire if they perform financial management services, subsequent conversations with members of "Big Eight" firms indicate that all of them provide such services. Financial management services involve designing and implementing electronic data processing and other services which help managements of client companies make financial decisions. Computer forecasting models and inventory control systems are examples of financial management services.

The "Big Eight" accounting firms provide a broad range of services traditionally performed by CPAs, as well as non-accounting services which are performed by management consulting firms. The rapid growth of management advisory services as a source of revenues for "Big Eight" firms has impaired their ability to act as independent auditors for publicly-owned corporations. The "Big Eight" firms are involved in providing management advisory services to varying degrees, but all of the firms derive substantial revenues from performing such services.

Concentration of Major Corporate Clients Among the "Big Eight" Accounting Firms

In its 19 December, 1975 questionnaire to the "Big Eight" accounting firms, this subcommittee requested the names of their corporate clients that have securities listed on either the New York Stock Exchange or the American Stock Exchange. All of the "Big Eight" firms provided that information in their responses which are contained in Appendix A.

The subcommittee requested that information because it is well-known that all of the major corporations in the United States have securities listed on either the New York Stock Exchange or the American Stock Exchange. It is also generally recognized that most of the major corporations in the United States employ one of the "Big

Eight" accounting firms as their independent auditor. There is a need for Congress and the public to have reliable data on the extent to which the "Big Eight" accounting firms dominate the auditing of the Nation's largest corporations.

The Congressional Research Service of the Library of Congress was requested by the subcommittee to tabulate and evaluate the data on major corporate clients that was submitted by the "Big Eight" accounting firms. The Library of Congress report is included in Appendix B at page 407. The manner in which the Congressional Research Service performed its evaluation is described within the body of the report.

The findings of the Congressional Research Service show an extraordinary degree of concentration among the "Big Eight" firms in providing auditing services to major corporations. This section briefly summarizes the primary findings by the Congressional Research Service. Reference should be made to the full report for its complete findings, along with an extensive amount of relevant financial and employment data developed by the Library of Congress. There are also many bar graphs and circular charts to illustrate the comparative significance of the factual data.

CRS METHODOLOGY

At the outset, two factors should be noted concerning the completeness and the accuracy of the Library of Congress report. The data sources used by the Congressional Research Service and its consultants are incomplete with regard to some companies and certain types of data for other companies. The report notes the companies for which no data was found, and the certain types of data which were not found for other companies.

Much of the information not found by the Congressional Research Service through its data sources is available to the public from other sources. Moody's Investors Service contains some of the missing data, and is available in most public libraries. All of the corporations listed on the New York Stock Exchange and the American Stock Exchange are publicly-owned and must file annual reports which contain much of the missing data with the SEC. Regulated companies also file useful information with Federal and State regulatory commissions.

Most of the 155 corporations for which the Congressional Research Service found no data are small in relation to the many large corporations which account for the bulk of financial and employment data on the New York Stock Exchange and the American Stock Exchange. Similarly, the only type of data which is significantly deficient for corporations with partial data is employment information. Thus, the impact of the missing information on the findings of the Congressional Research Service is insignificant in all categories except employment.

Interested persons may augment the data developed by the Congressional Research Service from other public information sources. The important point is that the missing information would increase the numbers used by the Congressional Research Service in its analysis of "Big Eight" firm dominance. Therefore, the findings of the Congressional Research Service are understated to the extent that missing data was not available for its analysis. The dominance of the "Big

Eight" firms in all categories is even greater than shown by the Library of Congress report, and is significantly greater concerning the number of employees hired by corporate clients of the "Big Eight" firms.

Another problem arose concerning the accuracy of the Library of Congress report because 24 corporations were claimed as clients by more than one "Big Eight" accounting firm. Those corporations and the "Big Eight" firms claiming them as clients are listed in Attachment 2 of the report. As noted in the report, the Congressional Research Service counted each of those 24 corporations as clients of both "Big Eight" firms claiming them as clients.

Because those 24 corporations appeared on the client lists of two "Big Eight" firms, their individual financial and employment data was included in the Congressional Research Service analysis of each "Big Eight" firm claiming them as a client. Thus, there is a very small amount of double-counting in the Congressional Research Service analysis.

The subcommittee staff checked with one of the "Big Eight" firms to discover why seven of its clients were also listed as clients of other "Big Eight" firms. It was found that the primary reason is the timing difference when a corporation changes from one "Big Eight" auditor to another. Unless all of the "Big Eight" firms list their clients as of the same date, a corporation changing auditors may appear on more than one client list.

The financial and employment data of the 24 double-counted corporations is small in relation to the total data used by the Congressional Research Service in its analysis, and the result of double-counting their data has no significant effect on the Congressional Research Service findings.

The Congressional Research Service analysis accurately portrays the total domination of the "Big Eight" firms as independent auditors of the corporations listed on the New York Stock Exchange and the American Stock Exchange. The analysis shows the vast economic impact of the "Big Eight" firms' corporate clients in terms of sales, net income, taxes, employees, and assets. Each of the "Big Eight" accounting firms is evaluated according to the economic strength of its corporate clients.

POWERS AND RESPONSIBILITIES OF INDEPENDENT AUDITORS

The powers and responsibilities of the "Big Eight" firms as independent auditors should be noted when interpreting the findings in the Library of Congress report. Each of the corporations identified as clients of the "Big Eight" firms must have its financial statements certified for accuracy by the "Big Eight" firm retained as its independent auditor. The independent auditor must agree that the accounting methods used by a corporate client result in a fair presentation of the corporation's financial affairs.

At present, there is flexibility in the type of accounting methods which may be used by a corporation to record the same business transaction. It can be vitally important to a corporation to have an independent auditor who agrees that a certain accounting method is proper when applied to a specific business transaction, and that financial statements using the desired accounting method accurately

portray the results of corporate operations. The financial results of corporate activities reported to the public can differ dramatically, depending on the type of accounting methods used to record business transactions.

Within the flexible guidelines presently used by independent auditors, a "Big Eight" firm has an extensive amount of discretionary authority to approve or disapprove the use of a certain accounting method to record a specific business transaction. Agreement by the independent auditor with a client's management on accounting matters can mean the difference between reporting healthy profits or severe losses. Professor Briloff's statement in Appendix K at page 1609 describes several cases where agreeable independent auditors permitted corporate clients to report "profits" that did not exist.

The power of approval over accounting methods used by corporate clients in financial statements is only part of the influence wielded by "Big Eight" accounting firms. As described in subsequent sections of this study, the "Big Eight" firms have strong influence over the promulgation of accounting methods that are available for use by corporate clients in the first place. The AICPA, which is controlled by the "Big Eight" firms, controls the Financial Accounting Standards Board which establishes acceptable accounting methods.

As independent auditors, the "Big Eight" firms are also responsible for checking the accounts of corporate clients to satisfy themselves that the business transactions reflected by financial statements actually occurred. They decide how much checking should be done, and which areas of corporate activity, if any, should be scrutinized most carefully.

Independent auditors have extensive influence over the financial results of corporate operations reported to investors, creditors, governmental authorities, and the public. The "Big Eight" accounting firms exercise their extensive influence as independent auditors for the Nation's largest corporations. The financial data used by the Congressional Research Service in its analysis results from accounting and auditing decisions made by corporate managements with the agreement of their "Big Eight" firm auditors.

The integral role of the "Big Eight" firms in determining the amount of sales, net income, income taxes, and assets reported by their corporate clients listed on the New York Stock Exchange and the American Stock Exchange must be remembered when evaluating the findings of the Congressional Research Service. Financial data of the "Big Eight" firms' corporate clients clearly shows that they have enormous impact on the Nation's economy. The "Big Eight" firms heavily influence the financial data reported by their corporate clients.

CRS FINDINGS

The Congressional Research Service found that there are a total of 2,641 corporations listed on the New York Stock Exchange and the American Stock Exchange. The "Big Eight" firms claim 2,248 or 85 percent of the total number of corporations listed on those exchanges as clients. The corporate clients of the "Big Eight" firms control most of the Nation's business wealth.

Using average annual data for the years 1974 and 1975, the Congressional Research Service compared data of the "Big Eight" firms' clients that are listed on the two major exchanges with data reported by the Department of Labor and the Department of Commerce. Approximately one-third of the Nation's 62.5 million employees in nonagricultural and nongovernmental establishments are employed by the corporate clients of the "Big Eight" accounting firms. Those same clients accounted for one half of the $2.552 billion in sales for the manufacturing, trade, and retail sectors. About 84 percent of the $75.4 billion of corporate profits after taxes was earned by the "Big Eight" firms' clients.

The Congressional Research Service analyzed the impact of the "Big Eight" firms' clients listed on each of the two major exchanges. The New York Stock Exchange reported that the securities of 1,543 corporations were listed on its exchange in 1974. Of those corporations, 1,417 or 92 percent * are clients of "Big Eight" accounting firms.

The "Big Eight" firms have 831 clients listed on the American Stock Exchange. That amounts to 76 percent * of the 1,098 corporations listed on that exchange in 1974. Thus, the dominance of the "Big Eight" accounting firms is much more pronounced on the New York Stock Exchange where the Nation's "blue-chip stock" corporations are registered. On both major exchanges, the "Big Eight" firms control the independent auditing for the bulk of the registered corporations.

For all the corporations listed on the New York Stock Exchange, the following percentages show what proportion of the respective data categories is associated with clients of the "Big Eight" firms:

94 percent of all sales (revenues) received,
94 percent of all profits earned,
90 percent of all income taxes paid,
94 percent of all people employed,
94 percent of all assets owned.

For all the corporations listed on the American Stock Exchange, the following percentages show what proportion of the respective data categories is associated with clients of the "Big Eight" firms:

67 percent of all sales (revenues) received,
67 percent of all profits earned,
66 percent of all income taxes paid,
61 percent of all people employed,
73 percent of all assets owned.

With regard to the "income taxes paid" category, the Congressional Research Service notes that the data reflects income taxes paid to all government authorities, not just the Federal Government. Studies performed by this subcommittee show that many large corporate clients of "Big Eight" firms pay minimal or no Federal income taxes.

The Congressional Research Service also measured the dominance of the "Big Eight" firms as independent auditors for the Nation's 50 largest corporations, ranked in each of five categories—sales, income, taxes, employees, and assets. The analysis shows that *all* of the 50

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* These percentage figures are based on the number of clients reported by the "Big Eight" firms and the total number of registered corporations reported by the exchanges. Using the number of clients reported by the "Big Eight" firms and the total number of corporations on the exchanges for which data was received or not found, the Congressional Research Service computed percentage figures that are marginally smaller due to the use of its different methodology. (See Appendix B, pages 419 and 420.)

largest corporations in *all* of the categories are audited by one of the "Big Eight" accounting firms. Thus, the "Big Eight" firms have complete control over the independent auditing of the Nation's 50 largest corporations in each category measured.

In its report, the Congressional Research Service evaluated the relative positions of the individual "Big Eight" accounting firms. All of them are large organizations with extensive influence, but some are more influential than others. The individual influence of the "Big Eight" firms relates to the identity and size of their corporate clients.

The "Big Eight" firms divide into three basic groups according to the number and economic power of corporations that are clients of the individual "Big Eight" firms. Price Waterhouse & Co. is in a class of its own as the most influential of the "Big Eight" firms. The second most influential group includes Arthur Andersen & Co., Coopers & Lybrand, Haskins & Sells, and Peat, Marwick, Mitchell & Co. The third group is comprised of Ernst & Ernst, Arthur Young & Co., and Touche Ross & Co.

For all of the data categories measured, the three groups of "Big Eight" firms demonstrate the relative influence exercised by individual firms. The "Big Eight" firms exercising the most influence have a greater number of major corporate clients, and their clients possess greater economic power.

The following tables are based on data contained in the Library of Congress report. They show the relative influence of individual "Big Eight" firms in terms of the economic power exercised by their corporate clients listed on each of the two major stock exchanges. The "Big Eight" firms are separated according to their three basic influence groups.

The percentages shown in the tables relate the clients of each "Big Eight" firm to all of the corporations listed on the designated stock exchange in each data category.

PERCENTAGE OF SALES OF ALL CORPORATIONS LISTED ON THE EXCHANGES FOR WHICH A "BIG EIGHT" FIRM ACTS AS INDEPENDENT AUDITOR

	New York Stock Exchange	American Stock Exchange
Price Waterhouse & Co	23.8	15.7
Arthur Andersen & Co	14.6	8.6
Coopers & Lybrand	11.7	6.3
Haskins & Sells	12.5	5.5
Peat, Marwick, Mitchell & Co	11.5	8.4
Arthur Young & Co	6.9	8.2
Ernst & Ernst	6.9	8.8
Touche Ross & Co	5.8	5.4
Total	93.7	66.9

PERCENTAGE OF NET INCOME OF ALL CORPORATIONS LISTED ON THE EXCHANGES FOR WHICH A "BIG EIGHT" FIRM ACTS AS INDEPENDENT AUDITOR

	New York Stock Exchange	American Stock Exchange
Price Waterhouse Co	28.1	19.3
Arthur Andersen & Co	15.6	11.2
Coopers & Lybrand	13.4	5.7
Haskins & Sells	12.7	7.0
Peat, Marwick, Mitchell & Co	9.6	5.5
Arthur Young & Co	5.8	7.8
Ernst & Ernst	6.3	5.4
Touche Ross & Co	2.6	4.8
Total	94.1	66.7

PERCENTAGE OF INCOME TAXES OF ALL COMPANIES LISTED ON THE EXCHANGES FOR WHICH A "BIG EIGHT" FIRM ACTS AS INDEPENDENT AUDITOR

	New York Stock Exchange	American Stock Exchange
Price Waterhouse & Co	36.0	19.1
Arthur Andersen & Co	13.1	10.4
Coopers & Lybrand	10.1	7.9
Haskins & Sells	8.7	5.0
Peat, Marwick, Mitchell & Co	7.0	5.6
Arthur Young & Co	8.2	6.8
Ernst & Ernst	4.8	6.6
Touche Ross & Co	2.0	4.4
Total	89.9	65.8

PERCENTAGE OF EMPLOYEES OF ALL CORPORATIONS LISTED ON THE EXCHANGES FOR WHICH A "BIG EIGHT" FIRM ACTS AS INDEPENDENT AUDITOR

	New York Stock Exchange	American Stock Exchange
Price Waterhouse & Co	19.6	13.5
Arthur Andersen & Co	14.8	9.3
Coopers & Lybrand	10.0	4.4
Haskins & Sells	14.8	5.4
Peat, Marwick, Mitchell & Co	14.0	6.6
Arthur Young & Co	5.6	9.4
Ernst & Ernst	7.2	8.3
Touche Ross & Co	8.1	4.3
Total	94.1	51.2

PERCENTAGE OF TOTAL ASSETS OF CORPORATIONS LISTED ON THE EXCHANGES FOR WHICH A "BIG EIGHT" FIRM ACTS AS INDEPENDENT AUDITOR

	New York Stock Exchange	American Stock Exchange
Price Waterhouse & Co	20.3	13.8
Arthur Andersen & Co	13.9	12.5
Coopers & Lybrand	13.1	6.8
Haskins & Sells	13.8	8.5
Peat, Marwick, Mitchell & Co	16.6	10.1
Arthur Young & Co	4.6	9.5
Ernst & Ernst	7.7	6.6
Touche Ross & Co	3.7	5.0
Total	93.7	72.8

The influence of individual "Big Eight" accounting firms as shown in the preceding tables is truly extraordinary. Price Waterhouse & Co. alone audits 24 percent of the total sales and 28 percent of the total net earnings for all the corporations listed on the New York Stock Exchange. The next four most influential "Big Eight" firms—Arthur Andersen & Co., Coopers & Lybrand, Haskins & Sells, and Peat, Marwick, Mitchell & Co.—collectively are the auditors for 50 percent of the total sales and 51 percent of the total net earnings for all of the corporations listed on the New York Stock Exchange.

Thus, the five most influential "Big Eight" accounting firms collectively are the independent auditors for 74 percent of the total sales and 79 percent of the total net earnings for all the corporations listed on the Nation's largest exchange, the New York Stock Exchange. That is a phenomenal degree of concentration in the performance of independent auditing services for the largest corporations in the United States.

The "Big Eight" position is almost as concentrated on the American Stock Exchange. Again, Price Waterhouse & Co. is the most influential "Big Eight" firm. About 16 percent of the total sales and 19 percent of the total net income for corporations listed on the American Stock Exchange is audited by Price Waterhouse & Co. alone. When the four "Big Eight" firms in the second most influential group are combined with Price Waterhouse & Co., those five accounting firms act as independent auditors for 45 percent of the total sales and 49 percent of the total net income for all the corporations listed on the American Stock Exchange.

The extraordinarily high concentration of independent auditing influence held by the five most influential "Big Eight" accounting firms is spread across both major stock exchanges, but is focused especially on the 50 largest corporations in the United States. The Congressional Research Service found that Price Waterhouse & Co. is the independent auditor for 17 of the 50 largest corporations in the United States, ranked according to sales. When the 50 largest corporations are ranked according to net income, Price Waterhouse & Co. is the independent auditor for 16 of them.

The next four most influential "Big Eight" firms—Arthur Andersen & Co., Coopers & Lybrand, Haskins & Sells, and Peat, Marwick, Mitchell & Co.—collectively are the independent auditors for 25 of

the 50 largest corporations ranked by sales, and 28 of the 50 largest corporations ranked according to net income. Combining their clients with those of Price Waterhouse & Co. shows that the five most influential "Big Eight" firms audit 42 of the 50 largest corporations in the United States, ranked according to sales. When ranked by net income, 44 of the 50 largest corporations are audited by those five "Big Eight" firms.

The Library of Congress report prepared for this subcommittee also analyzed the concentration of "Big Eight" firms as independent auditors for the ten largest corporations in each of six selected industries. Those industries are natural resources, banks and bank holding companies, chemicals, drugs and pharmaceuticals, general machinery and equipment, and electric power companies and holding companies. The results of the analysis generally show that two or three "Big Eight" firms are the independent auditors for most of the ten largest corporations in a particular industry.

Price Waterhouse & Co. is strongly entrenched as the independent auditor for certain of the top ten corporations in all six industries selected. However, Price Waterhouse & Co. has especially strong influence over the accounting methods used by the natural resource industry because the firm is independent auditor for six of the ten largest corporations in that group. All of the top ten natural resource corporations are major oil and gas companies, and the accounting methods used by such corporations have been the subject of much controversy.

EFFECTS OF CONCENTRATION

There are many disturbing aspects to the extremely high concentration of major corporate clients audited by the "Big Eight" accounting firms. The most important problem is the anti-competitive effect of such concentration on the supply of independent auditing services to the largest corporations in the United States. Because of the special role of independent auditors in the economy, the concentration of auditing influence among the "Big Eight" firms presents some unique problems, in addition to the traditional problems associated with anti-competitive practices.

Traditionally, lack of competition creates problems concerning the price of goods and services, their quality, the terms upon which they are offered, and the development of improved goods and services that reduce the value of existing goods and services. The traditional problems associated with lack of competition and excessive market concentration may be evident in the supply of auditing, accounting, and other services by the "Big Eight" firms to major corporations. The extremely high concentration of major corporate clients among the "Big Eight" firms—and especially among the five most influential "Big Eight" firms—certainly presents a situation calling for further investigation into the anti-competitive effects which may reasonably be expected to result from such concentration.

Moreover, the special role of the "Big Eight" firms as independent auditors would aggravate the anti-competitive situation which can result from excessive market concentration. For example, performance of management advisory services for a corporate client is a natural "tie-in" to the performance of independent auditing services for the

same client, since the client's management can reasonably expect the independent auditor to favorably audit the results of its own work. Regular business consulting firms cannot implicitly offer the expectation that their services will be approved by a client's independent auditor.

Another unique problem resulting from the special role of independent auditors is the broad scope of their practice. As previously noted, the "Big Eight" firms as independent auditors have extensive influence over the financial results reported to the public by corporate clients. To a degree unparalleled by other groups in the private sector, the primary business of the "Big Eight" firms is to be intimately involved in the presentation of corporate financial results.

The success or failure of financial results reported to the public usually determines the future acceptance of management by a corporation's shareholders and creditors. The extensive influence maintained by a "Big Eight" accounting firm over the financial success of a corporate client in one particular industry may also exist for one or more other corporate clients in the same industry. As documented in the Library of Congress report, Price Waterhouse & Co. is the independent auditor for several major corporate competitors in the six industries surveyed. Other "Big Eight" firms also act as independent auditors for more than one of the major corporate competitors in a single industry.

The "Big Eight" firms not only concentrate their influence among major competitors in a single industry, but spread their concentrated influence through other major industries. Independent auditing is one service required by all major corporate competitors in all industries. The spread of "Big Eight" firm concentration through major industries is one of the primary factors contributing to the vast size and influence of the "Big Eight" firms.

Price Waterhouse & Co., as noted previously, exercises concentrated influence in the natural resources industry by acting as the independent auditor for six of the ten largest corporate competitors in that industry. Simultaneously, Price Waterhouse & Co. exercises the same type of concentrated influence in the general machinery and equipment industry, as the independent auditor for four of the top ten competing corporations. Similar influence is exercised concurrently in other industries by Price Waterhouse & Co. and other "Big Eight" accounting firms.

The "Big Eight" firms also have a forum for privately meeting together and discussing subjects of mutual interest through their membership in the AICPA, which they control. At the suggestion of some big accounting firms, the AICPA established five advisory committees representing different segments of the AICPA's membership to promote their respective interests within the AICPA. (See page 83 for a description of the AICPA's advisory committee system.)

One of the five AICPA advisory committees is assigned to represent the interests of the Nation's 15 largest accounting firms. That advisory committee has 11 members, eight of whom permanently represent the interests of the individual "Big Eight" accounting firms. At their periodic meetings, the members have discussed such topics as the need for a political action committee to influence members of Congress.

Their AICPA advisory committee is one organized forum where the "Big Eight" firms have the opportunity to meet privately and promote anti-competitive activities. The AICPA provides other forums where some or all of the "Big Eight" firms could promote anti-competitive activities. The AICPA has many committees that meet to formulate AICPA policies and programs in specific areas of interest to CPAs. As described subsequently in this study, all of the AICPA committees dealing with important matters of interest are dominated by representatives of the "Big Eight" firms.

Any of those committees could act as a vehicle for promoting anti-competitive activities in a specific area of interest. Examples of AICPA actions which could be construed as promoting anti-competitive practices include the dissolution of the AICPA's committee to aid displaced CPA firms, and adoption of a plan sponsored by the "Big Eight" to have large accounting firms voluntarily inspect one another to assure quality of practice. Both actions were criticized by small CPA firms, and both are described subsequently in this study. (See pages 101 and 114.)

A further disturbing aspect of the extraordinary influence concentrated among the "Big Eight" firms is that it appears to be increasing. As a byproduct of the corporate merger movement that has concentrated control over the Nation's economic resources among fewer and fewer institutions and individuals, small and medium-sized CPA firms have been displaced as independent auditors by the "Big Eight" and other large accounting firms. When smaller companies are merged into larger corporations, which generally have a "Big Eight" firm as independent auditor, the CPA firms that formerly audited the small companies usually lose their clients to the "Big Eight" firms.

Displacement of small CPA firms by "Big Eight" firms also occurs when companies "go public" by selling their shares to the public. Underwriters and bankers often inform companies that a nationally known firm must be retained as independent auditor in order to sell securities to the public at the highest possible price, or obtain a necessary loan. An article in the June, 1971 issue of the Journal of Accountancy, entitled "Displacement of Auditors When Clients Go Public," described the displacement of small CPA firms by larger firms. (See Appendix K, page 1743.)

Concentration of auditing influence among the "Big Eight" accounting firms has occurred through direct mergers of small CPA firms into the large national firms, as well. Sometimes the small CPA firms have no choice but to merge with large national firms that have taken major clients from the small CPA firms. A few of the "Big Eight" firms have achieved significant growth through a program of mergers with smaller firms.

This subcommittee has received complaints about anti-competitive practices by "Big Eight" firms from the accounting profession and the business sector. Most of the complaints have come from CPAs associated with small and medium-sized CPA firms. They have encouraged the subcommittee and the Federal Government to correct the anti-competitive situation which they believe exists. Examples of the type of complaints expressed by smaller accounting firms are included in Appendix K.

One of the complaints about anti-competitive practices by "Big Eight" firms was from Kenneth Leventhal & Co., which claims that it is the 25th largest accounting firm in the Nation. Kenneth Leventhal & Co. offered to provide material support for its charge, but a subcommittee request for such materials has failed to elicit any response. (See Appendix K, page 1731.)

The information which this subcommittee has received from the "Big Eight" firms and other sources clearly shows an excessively high concentration of auditing influence among the "Big Eight" firms. The degree of concentration in providing independent auditing services to major corporations is so great that it constitutes evidence of a serious lack of competition. The "Big Eight" firms control the performance of vitally important independent auditing services for the bulk of the economic power held by the corporations on the New York Stock Exchange and the American Stock Exchange.

This study notes the adverse effects of excessive concentration in the performance of independent auditing services. More research is needed to document fully the extent of the anti-competitive situation represented by the excessive concentration of influence among the "Big Eight" accounting firms. Enough is presently known to justify immediate action by Congress and Federal agencies to restore competitive balance in the performance of independent auditing services for major corporations. Because independent auditors serve a special purpose in the Nation's economy, factors other than restoring competition must also be considered to assure that independent auditing services are performed properly.

Profitability of the "Big Eight" Accounting Firms

A successful accounting practice is a very lucrative enterprise. The "Big Eight" firms have augmented traditionally profitable accounting services with an array of profitable management advisory services that do not involve accounting expertise.

Because CPAs generally practice accounting as business partnerships which do not report to the public, there is little data available to the public on the profitability of accounting firms. However, some data is available within the accounting profession. This subcommittee has reviewed certain data on the profitability of accounting firms, and its conclusions have been confirmed by practicing CPAs, as well as unsolicited data received by the subcommittee.

Accounting firms are service organizations which do not require substantial tangible assets or capital expenditures to operate. Office expenses and staff salaries are the major deductions in computing the net profit available for the partners in an accounting firm after operating expenses have been deducted from their total revenues. As a result, profit margins are usually quite high.

A CPA practicing on his own in a sole proprietorship can net better than 50 percent of his total revenues as profit for himself. The average partnership of CPAs can earn more than 40 percent of its total revenues as net profit. Even though the net profit margin is typically lower for a partnership than for a single practitioner, individual partners tend to earn more money than single practitioners because partnerships have proportionately greater revenues.

The proportion of overhead expenses rises as the size of a partnership increases, but the ability to provide services also increases. The increased ability to provide services means that a larger partnership can serve more clients and bigger individual clients. The resulting increase in total revenues more than compensates for the higher proportion of overhead expenses, and generally enables individual partners in larger partnerships to earn more money.

Arthur Andersen & Co. has voluntarily reported that it had total revenues of $386,341,000 and net earnings of $90,818,000 for its fiscal year ending 31 August, 1975. The firm's net profit margin was 23.5 percent. Arthur Andersen & Co.'s 1975 financial statements are included in Appendix A at page 200 as an example of the types of expenses involved in operating one of the "Big Eight" accounting firms.

The net profit margins of "Big Eight" firms are lower than those of smaller accounting firms because of the substantial overhead expenses involved with operating such large organizations. Partners of "Big Eight" firms are compensated for increased overhead expenses by the tremendous volume of revenues their firms are able to generate.

The subcommittee staff estimates that all of the "Big Eight" accounting firms have net profit margins in the range of 25 percent. Based on the staff's estimate that the "Big Eight" firms have total annual revenues of over $2 billion, their total net earnings are more than $500 million each year. That is a substantial sum of money to be apportioned among the few thousand individuals who are the partners of the Nation's eight largest accounting firms. Arthur Andersen & Co. reported that the average earnings for each of the firm's active partners at the end of its 1975 fiscal year was $95,152. The financial rewards of partnership in a "Big Eight" firm are obviously quite attractive under their existing system of accounting practice.

The top partners of the "Big Eight" accounting firms are the policymakers who decide which direction the firms shall take in providing services to clients. As noted previously, the "Big Eight" firms have substantial direct and indirect impact on Federal accounting practices, as well as other policies and programs of the Federal Government. Therefore, it is important to know the financial interests of those individuals.

In order to evaluate the financial interests of the top partners in the "Big Eight" firms, this subcommittee requested the total annual compensation earned by each of the three highest-paid individuals in each of the "Big Eight" firms.

Only Arthur Andersen & Co. and Price Waterhouse & Co. cooperated with the subcommittee by providing the requested information. Most of the remaining "Big Eight" firms said that data on compensation was not relevant to the subcommittee's study, and that revealing such data would amount to an invasion of privacy.

Several firms expressed concern that the subcommittee would not understand the compensation of top partners because their compensation is not truly comparable with the compensation earned by corporate executives. The responses from all of the "Big Eight" firms are included in Appendix D beginning on page 847.

The open responses of Arthur Andersen & Co. and Price Waterhouse & Co. show that the concerns of the other "Big Eight" firms are

unwarranted. The compensation of top partners reported by Arthur Andersen & Co. and Price Waterhouse & Co. are certainly substantial, but are not greatly out of line with the salaries of top executives of major corporations which are clients of these multimillion dollar accounting firms. Arthur Andersen & Co.'s response also provides a detailed description of the manner in which the firm's top partners are compensated, and how their compensation differs from compensation of corporate executives.

The annual compensation of each of the three highest-paid partners at Arthur Andersen & Co. is $429,843, $388,716, and $349,609. Price Waterhouse & Co. states that its three highest-paid partners earn respectively $316,134, $297,920, and $281,275. The compensation figures reported by the two firms may have been computed by different methods, and thus may not be completely comparable.

Sources within the accounting profession have told the subcommittee staff that top partners at other "Big Eight" firms earn more than the amounts reported by Arthur Andersen & Co. and Price Waterhouse & Co. The subcommittee is unable to substantiate or dismiss such reports because six of the "Big Eight" firms refused to provide factual information.

The reasonability of compensation earned by top partners of "Big Eight" firms is not the concern of this subcommittee. The information reported on compensation of top partners is relevant to this study because it clearly indicates that, by any definition, the policymaking partners at "Big Eight" firms have a very substantial financial interest in preserving the existing style and scope of practice which they now enjoy. Substantive changes in accounting standards or the type of services which may be offered by "Big Eight" firms could significantly affect the earnings of partners in those firms.

Partners in "Big Eight" firms have substantial financial interests at stake in preserving the *status quo* regarding the structure of the accounting profession, the standards CPAs must follow, and the broad scope of accounting and non-accounting services which are offered by large accounting firms. The substantial financial interests of the "Big Eight" firms indicate that those firms have a strong vested interest in avoiding changes in the present system which might reduce the financial value of their services to clients. Correction of improper, but profitable, practices by accounting firms through internal self-reform appears unlikely in view of the financial interests held by the "Big Eight" firms, which dominate the accounting profession.

Independence of the "Big Eight" Accounting Firms

The "Big Eight" accounting firms primarily affect the Federal Government and its programs through their role as the independent auditors for the vast majority of the Nation's largest corporations. Eighty-five percent of the corporations listed on either the New York Stock Exchange or the American Stock Exchange employ a "Big Eight" firm to act as their independent auditor. The "Big Eight" firms have great influence over the reported operating results of major corporations because the firms dominate both the development and application of auditing and accounting standards used by their clients.

Enactment of the Federal securities laws created a special role in society for CPAs who act as independent auditors. Because the Fed-

eral securities laws were specifically enacted to protect the interests of investors and other third parties, independent auditors owe their primary allegiance to the persons who rely on financial statements, rather than the corporations that issue financial statements. The independent auditing provisions of the Federal securities laws are the key to their effectiveness because disclosure of material information is the basis for protecting the public from poorly managed corporations. To be useful in protecting the public, however, information disclosed on corporate activities must be accurate.

A three-party relationship exists for CPAs who serve as independent auditors of publicly-owned corporations. The three parties in interest are the CPA, the client corporation, and the public. Although the independent auditor is retained and paid by the corporate client, the Federal securities laws clearly require that the services of the independent auditor be performed for the benefit of the public. Corporate managements may also benefit from the application of auditing and accounting services designed to produce accurate information on the results of corporate activities, but the Federal securities laws were not enacted for their protection.

Members of the public expect that an independent auditor will protect their interests and will not promote his client's interest at their expense. It is improper for independent auditors to act as advocates on behalf of their clients' interests.

The major responsibility of independent auditors is to perform their services while maintaining strict independence from their clients, both in fact and in appearance. Public confidence in the accuracy and usefulness of corporate financial information depends upon a firm belief that such information has been checked and certified by qualified auditors who are truly independent. Confidence in the independence of auditors requires that they have no direct or indirect interests in the affairs of their clients.

In administering the Federal securities laws, the Securities and Exchange Commission (SEC) has defined the qualifications of accountants who may act as independent auditors. (See Appendix I, p. 1431.) The SEC "will not recognize any certified public accountant or public accountant as independent who is not in fact independent." The SEC further requires:

> In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission.

Thus, the requirements are clear that a CPA acting as an independent auditor of a publicly-owned corporation must be independent in fact with regard to his total relationship with that corporate client. The standards of conduct followed by independent auditors must preserve their independence. Activities of CPAs which promote the interests of corporate clients erode public confidence regarding the independence of auditors.

By mandating the practice of independent auditing, Congress created a special position for CPAs that is unmatched by any other profession or business in the private sector. Independent auditors are different from other participants in the Nation's economy for the very

reason that they are endowed with the reputation for objectivity and impartiality associated with the concept of independence. They alone are regarded as the disinterested umpires who assure that self-interested businessmen accurately report the results of their activities, as required by the Federal securities laws.

Enactment of the Federal securities laws imparted special stature to the accounting profession, while guaranteeing CPAs a consistent demand for their services as independent auditors. The "Big Eight" and other large accounting firms readily accepted the special stature associated with their designated role as independent auditors, but they have not fully accepted the special responsibilities which accompany the position of independent auditor. In fact, they have used their designated reputation for independence to market a variety of non-accounting services.

This subcommittee has collected an abundance of materials demonstrating activities of "Big Eight" accounting firms which impair their ability to act as independent auditors for the vast majority of the Nation's large corporations. Many examples have been selected from those materials, and are included in this study to illustrate the type of activities undertaken by "Big Eight" firms which contradict their claim to act independently in the public interest. The "Big Eight" accounting firms are in fact not independent (See p. 54.)

The lack of independence of "Big Eight" firms results from the scope of client services they perform for profit and the activities they undertake on their own. This section summarizes the types of "Big Eight" activities which conflict with their role as independent auditors. The subsequent sections describing each of the "Big Eight" firms individually include specific examples of the activities summarized in this section.

MANAGEMENT ADVISORY SERVICES

Performance of management advisory services is the primary problem area regarding the services offered by "Big Eight" firms for profit. The performance of management advisory services necessarily involves the "Big Eight" firms in the business operations of their corporate clients. Their involvement in the business operations of their clients conflicts with the "Big Eight" firms' obligation to be independent in fact from their clients. The "Big Eight" firms cannot act effectively as independent auditors when they have financial and professional interests in the business operations of their clients.

The management advisory services described at page 34 are examples of the conflicting interests which arise when an independent auditor becomes involved in the business of a client. Seven of the "Big Eight" firms provide executive recruitment services for their clients. Those firms are involved in placing influential executives who have a bearing on the business operations of their clients. As such, those seven firms have a direct financial and professional interest in assuring that the executives recruited through their efforts are successful in helping the business operations of their clients.*

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* This subcommittee has received a detailed description of the manner in which the performance of management advisory services, especially executive recruitment, by accounting firms directly conflicts with their responsibility to be independent in fact and appearance from the interests of corporate clients. The description is included as part of a letter from the president of a professional personnel agency which must compete against the undue advantage of independent auditors who also provide executive recruitment services. (See Appendix K, page 1736.

If executives recruited by "Big Eight" firms are not successful, then the financial value of the firms' executive recruitment services to clients is impaired, and may result in a loss of revenues for "Big Eight" firms. Failure in performing management advisory services also impairs the overall professional reputation of "Big Eight" firms. The value of all services performed by "Big Eight" firms is enhanced by the reputation for accuracy which is associated with the concept of independent auditor. Failure in providing any area of services may damage the professional reputation for competence needed by "Big Eight" firms to act effectively as independent auditors.

Even if the "Big Eight" firms are successful in providing management advisory services, questions may be raised concerning the procedures and standards used to audit a client which employs executives recruited by its independent auditor. There may be reasonable doubts as to the thoroughness of the independent audit or the suitability of the accounting standards used in preparing the client's financial statements. Such doubts arise because the independent auditor has a direct financial and professional interest in having the client appear successful in its reports to the public.

The public may reasonably doubt the ability of a "Big Eight" firm to act as independent auditor for a corporate client where one or more of the client's influential executives have been recruited by the "Big Eight" auditor. Similarly, corporate shareholders and others may wonder if a "Big Eight" firm is being retained as a corporation's independent auditor primarily because of the relationship existing between the "Big Eight" firm and the influential executives it recruited. Reasonable doubts are necessarily raised when an independent auditor becomes involved in the business operations of a client.

The conflicts of interest which arise when an independent auditor recruits executives for its clients also arise in regard to the performance of other management advisory services by independent auditors. For example, a "Big Eight" firm that performs a marketing study which causes a client to market a new product has a direct financial and professional interest in the success of that product. Because of its self-interest in having that segment of the client's business succeed, the "Big Eight" firm cannot act independently as the auditor for such a client. The same problems occur when a "Big Eight" firm performs plant layout, product analysis, and similar services for its clients.

The performance of actuarial services by "Big Eight" accounting firms presents an even greater conflict of interest. Contributions by corporations to employee pension plans generally have a direct and substantial impact on corporate earnings. When an accounting firm provides actuarial services relating to such plans for a corporate client, the firm is directly involved in working with the client's management on matters which may substantially affect the client's earnings. An accounting firm cannot properly act as the independent auditor for such a client.

Financial management services also involve conflicts of interest when performed by "Big Eight" accounting firms for their clients. Not only do the "Big Eight" firms become involved in management information systems that influence the direction of a client's business; they may be put in the position of auditing the reliability and accuracy of their work. The "Big Eight" firms cannot be independent

in fact from clients that are using their financial management services.

TAX SERVICES

Management advisory services are only one of the activities contributing to the loss of independence by the "Big Eight" accounting firms. Tax services are another area where the "Big Eight" firms have impaired their ability to act as independent auditors.

The firms actively engage in advocacy of clients' positions regarding taxation of corporations. Their views on tax issues parallel the views expressed by the managements of their corporate clients and business lobbying groups. They support increased investment tax credits, more liberalized depreciation methods, continuation of tax credits rather than deductions for taxes paid to foreign governments, and other procedures designed to increase the amount of cash held by big corporations.

The "Big Eight" accounting firms have not recognized the distinction between an independent auditor's proper concern with the efficient application of existing tax laws and partisan advocacy to change the substance of tax laws. Advocacy of controversial positions on political issues involving the fair distribution of taxes results in a loss of independence because the auditor's interests become associated with the interests of his clients or some other special interest group. Public confidence in the impartiality and objectivity of independent auditors is seriously eroded when the "Big Eight" firms openly promote the tax views of their corporate clients.

Many segments of the public to whom independent auditors are responsible may not agree with the political views promoted by the "Big Eight" firms on behalf of the managements of their corporate clients. Nevertheless, "Big Eight" firms appear before Congress, State legislatures, and Federal and State agencies to testify as to how corporations should be taxed to correct alleged unfair tax burdens on businesses. Political activity by "Big Eight" firms on controversial tax issues is one example of the manner in which auditors lose independence through deliberate identification with the narrow self-interests of corporate clients.

REPRESENTATION OF CLIENTS' INTERESTS

The "Big Eight" accounting firms readily identify with the self-interests of corporate managements on many controversial issues in addition to the fairness of corporate taxation. They testify before State regulatory commissions on the amount of profits which should be earned by regulated utilities, and in support of automatic cost adjustment clauses which circumvent the regulatory process. "Big Eight" firms support inclusion of construction work in progress in regulated utility rate bases, as well as charging utility customers for Federal income taxes that are never paid to the Federal Government.

They testify before Congress in support of higher oil and natural gas prices, and for faster write-offs of production costs. "Big Eight" firms write to Federal agencies to urge adoption of rules that would

have the Federal Government pay private contractors for "costs" that are not normally accepted costs at all. They oppose more stringent Federal regulations on reporting by corporations, and recommend that the Federal Government not adopt uniform accounting methods.

All of these are examples of the biased positions taken by "Big Eight" accounting firms which are incompatible with their role as independent auditors. Sometimes they promote a partisan view on a controversial issue as a "public service" on their own initiative. At other times they make a presentation on behalf of a client for a fee.

Independent auditors are endowed with a public reputation for impartiality and objectivity because of the special role assigned to them by Congress in the Federal securities laws. Their statements and recommendations are accorded great respect and credibility because of the general belief that such statements and recommendations are made independently.

When the management of a regulated utility or a recognized utility consultant testifies that utility profits are insufficient, the self-interest of those testifying is clearly evident, and their testimony is accepted accordingly. However, testimony by an independent auditor that certain policies result in insufficient utility profits often seems more credible because of the reputation for impartiality and objectivity associated with independent auditors. The "Big Eight" accounting firms have recognized the market value of their reputations as independent auditors. They use their special position to promote the vested interests of corporate clients for a profit.

Another example where the "Big Eight" firms lose independence by identifying themselves with partisan business interests is their association with recognized business lobbies. Partners of "Big Eight" accounting firms testify before Congress and State authorities as leaders of the Chamber of Commerce. The reputations of the firms and the mantle of the Chamber thus are bestowed upon the interests of the firm's large corporate clients.

(Specific examples of activities causing loss of independence are described in relation to individual firms beginning on page 54. Reference should also be made to partisan political activities of the AICPA which is controlled by the "Big Eight" firms and acts on their behalf. See page 101.)

In view of the SEC requirement that CPAs must be independent in fact in regard to all relationships with clients, questions arise as to how the "Big Eight" firms have been permitted to pursue their varied activities. The answers lie in the "Big Eight" firms' dominance over the self-regulatory apparatus of the accounting profession, and the reliance of the SEC on the AICPA. The AICPA, which is controlled by the "Big Eight" firms, develops the behavior standards that are generally recognized by the SEC and State regulatory boards.

Under the control of the "Big Eight" accounting firms, the AICPA has encouraged CPAs to perform a broad range of management advisory services. The AICPA has also developed ethical standards for CPAs that apparently do not prohibit the partisan relationships of the "Big Eight" firms with their corporate clients. For its part, the SEC has relied upon the AICPA to determine what standards of conduct are proper for CPAs. The close relationship between the

SEC and the AICPA is described in subsequent sections of this study.

The Nation's large publicly-owned corporations are ably staffed with their own accountants who prepare and advocate corporate views on accounting matters. There is no need for the "Big Eight" accounting firms to engage in their many controversial nonaccounting activities, other than to earn more money or ingratiate themselves with corporate clients.

The traditional public image of the "Big Eight" accounting firms as impartial and objective experts is not founded on fact, and is misleading as to their true status. As political partisans and purveyors of nonaccounting services, they become loyal agents of the clients which employ their services. As independent auditors, the "Big Eight" firms are unable to perform their responsibilities in a manner which commands public confidence.

Illustrative Questionable Activities of Individual "Big Eight" Accounting Firms

The "Big Eight" accounting firms are involved in a wide variety of activities which significantly affect practically all segments of the Nation's economy, as well as society in general. The Federal Government and its policies and programs are especially influenced by the "Big Eight" firms. This section provides some examples of their activities by describing specific projects of individual "Big Eight" firms.

This subcommittee received a large volume of materials in response to its request to the "Big Eight" firms for copies of their recent presentations before Congress, State legislatures, and Federal and State regulatory agencies. Additional materials from other sources have been collected and reviewed by the subcommittee staff. Review of all the materials received by the subcommittee has revealed that these firms have been involved in a substantial number of improper or questionable activities.

The materials described in this section have been selected to illustrate the different types of improper or questionable activities practiced by "Big Eight" firms. They do not provide a comprehensive description of all the improper or questionable activities practiced by each firm. Some of the particular characteristics of individual "Big Eight" firms are also illustrated by this section.

An indication of the scope of activities practiced by individual firms is provided by the index to materials submitted by each firm. The indices submitted by some "Big Eight" firms are far more descriptive than others, but all of the indices submitted are useful as indicators. The volume of materials submitted was so great that only a small portion of it is included in this study as examples of their activities.

Although the examples included in this study are not comprehensive, they do illustrate the serious problems which exist regarding the activities of "Big Eight" firms. Three of the firms have been officially disciplined by the SEC for improper activities. Other sections of this study provide additional examples of questionable activities by organizations controlled by the "Big Eight" firms.

ARTHUR ANDERSEN & CO.

Arthur Andersen & Co. is widely regarded as the most aggressive "Big Eight" firm in terms of promoting the positions adopted by the firm on political and accounting issues. News accounts often refer to it as the "maverick" within the accounting profession. Materials reviewed by the subcommittee staff confirm that Arthur Andersen & Co. is aggressive in promoting interests of the firm and its clients.

The response of Arthur Andersen & Co. to this subcommittee's information request is included in Appendix C beginning on page 571. It is the only major CPA firm which provides information to the public concerning its financial position. An important part of the firm's public information program is the annual report which it voluntarily prepares each year. Because of space limitations, Arthur Andersen & Co.'s 1975 annual report is not included in this study. However, the financial statements from its 1975 annual report are included in Appendix A at page 200. Complete copies of its annual report can be obtained directly from Arthur Andersen & Co.

Arthur Andersen & Co. and Price Waterhouse & Co. are the only two "Big Eight" firms which cooperated fully in providing information to this subcommittee. Many of the other major accounting firms have criticized the public information program of Arthur Andersen & Co. The proportionately greater number of questionable or improper activities by Arthur Andersen & Co. noted in this study do not necessarily imply that the firm engages in such activities more than other "Big Eight" firms. Instead, it may reflect the fact that Arthur Andersen & Co. has been more open and forthright in providing information on its activities to this subcommittee.

Arthur Andersen & Co.'s annual reports are a useful source of information for understanding the activities of a large and influential accounting organization. However, limitations resulting from the obvious promotional nature of the reports, and the fact that the financial statements are not independently certified, must be recognized when using them.

It was the first "Big Eight" firm to have its operations reviewed by an "independent" public review board. (See Appendix C, page 648.) Not surprisingly, the public review board found that Arthur Andersen & Co. "conscientiously and competently carried out" its responsibilities. In fact, the public review board was not independent and did not represent the public. Arthur Andersen & Co. selected the five review board members and paid each of them $20,000.

The review board praised the firm's operations, and openly advocated Arthur Andersen & Co.'s views concerning the need for "inflation-adjusted" accounting methods, which was not relevant to evaluating the firm's efficiency and competence.

Arthur Andersen & Co.'s review board also recommended that the firm's partners should reduce their independence by becoming more active in politics, and by seeking employment in industry after retirement. The real usefulness of the review board's report lies not in its recommendations and findings, but in ably demonstrating the problems and conflicts of interest involved with permitting major accounting firms to review themselves for competence and independence.

The SEC has issued Accounting Series Release 157 condemning faulty auditing practices by Arthur Andersen & Co. The SEC statement also criticizes intentional efforts by Arthur Andersen & Co. to mislead the SEC staff. (See Appendix C, page 638.) In another case, Arthur Andersen & Co. failed to follow up information it was given that Merck & Co., one of its clients, was making questionable foreign payments. Arthur Andersen & Co. reportedly knew that at least one such payment was illegal. (See Appendix C, page 649.)

Arthur Andersen & Co. recently filed a complaint with the SEC alleging that the SEC has illegally acted to require CPAs to state whether an accounting change by a client is preferable. The complaint also alleges that the SEC illegally requires CPAs to follow all past and future accounting standards established by the private sector's Financial Accounting Standards Board (FASB). Arthur Andersen & Co. has brought suit in Federal court to enforce its complaint against the SEC.

Arthur Andersen & Co.'s description of its complaint and the firm's reaction to criticism of its complaint are included in Appendix C at page 650. News articles describing the complaint and criticism of Arthur Andersen & Co. within the accounting profession are also included.

The process by which the FASB establishes accounting standards that are recognized by the SEC is fully described in subsequent sections of this study. Arthur Andersen & Co. has raised valid questions concerning the legality of the process by which the SEC grants official recognition to accounting standards developed by the FASB.

Regarding its efforts to influence Federal and State authorities, Arthur Andersen & Co. has provided this subcommittee with an excellent synopsis of the many presentations made by the firm's representatives. (See Appendix C, page 573.) The index and synopsis clearly show the wide variety of questionable activities which the firm has undertaken. Some of those activities were performed for clients, some were performed as a "public service," and others were performed for groups such as the Chamber of Commerce.

An example of Arthur Andersen & Co.'s "public service" efforts is the firm's statement before the House Ways and Means Committee, dated 15 July, 1975. (See Appendix C, page 624.) That statement openly advocates retention of controversial foreign tax benefits for multinational corporations. The views expressed agree with the views expressed by big business lobbyists, but Arthur Andersen & Co.'s reputation as an independent auditor lends more credibility to its partisan statements.

The public review board hired by Arthur Andersen & Co. stated: "The firm does not, we understand, engage in lobbying efforts on behalf of clients. Also, the firm will not, as a matter of policy, undertake tax engagements which require a legislative solution." Although Arthur Andersen & Co.'s statement in strong support of controversial foreign tax benefits for corporations was performed as a "public service," existing and potential corporate clients of Arthur Andersen & Co. could be expected to view favorably the firm's advocacy of big business interests.

Another example of questionable or improper activities by Arthur Andersen & Co. is the statement made by one of its partners as vice president of the Greater Boston Chamber of Commerce. (See Appendix C, page 622.) That statement uses strong rhetoric and misleading factual assertions to oppose the creation of a public power authority in Massachusetts. Arthur Andersen & Co. is the independent auditor for several of the Nation's largest electric utility monopolies that are vehemently opposed to municipal or State ownership of electric power facilities.

Arthur Andersen & Co. submitted many more examples of its activities than could be included in this study because of space limitations. However, certain other examples should at least be mentioned:

Arthur Andersen & Co. testified on behalf of four electric utilities before the Florida legislature recommending that controversial accounting methods be used to charge utility customers for taxes which are not paid by electric utilities.

An Arthur Andersen & Co. partner presented a statement on behalf of the Greater Boston Chamber of Commerce in opposition to electric rates designed to conserve electric energy and reduce costs for residential customers. The statement said that customers would not save much, but that 36,000 jobs would be lost.

Arthur Andersen & Co. testified as a "public service" before the Nevada legislature in regard to controversial methods of setting utility rates. Arthur Andersen & Co. advocated use of fuel adjustment clauses, inclusion of construction work in progress in utility rate bases, and use of accounting methods that charge customers for taxes that are not paid. All of those rate-making methods unfairly increase the cash flow of utilities at the expense of customers.

Arthur Andersen & Co. testified before the Subcommittee on Energy and Power of the House Committee on Interstate and Foreign Commerce in support of including construction work in progress in electric utility rate bases. Adoption of that recommendation would unfairly raise the price of electricity for customers.

An Arthur Andersen & Co. partner testified on behalf of the Greater Boston Chamber of Commerce in support of Massachusetts State taxes that would retain a flat tax rate rather than a graduated rate, decrease the taxes on unearned income, increase the deduction for capital gains to 50 percent, increase the sales tax, and widen the sales tax base.

ARTHUR YOUNG & CO.

Arthur Young & Co. is one of the smaller "Big Eight" accounting firms. The firm's response to this subcommittee's request for information is included in Appendix C beginning on page 658. The index to materials submitted gives some examples of questionable activities by the firm. (See Appendix C, p. 659.)

Arthur Young & Co. is the independent auditor for Lockheed Aircraft Corp. Lockheed has had financial problems for several years.

As independent auditor for Lockheed, Arthur Young & Co. has approved the use of accounting methods which possibly misrepresent Lockheed's actual financial situation. To the extent that it has approved such accounting methods, Arthur Young & Co. has served the interests of Lockheed's management rather than the public interest.

The accounting practices used by Lockheed have been described to the subcommittee by Dr. Abraham Briloff, Emanuel Saxe Distinguished Professor of Accounting, Baruch College, City University of New York. His letter also describes the failures of the SEC and the General Accounting Office to perform proper oversight of Lockheed's accounting practices in accordance with the loan guarantee enacted by Congress. (See Appendix K, p. 1605.) Because of the Federal loan guarantee for Lockheed, possibly misleading accounting practices used by the company and approved by Arthur Young & Co. are an area of special interest to the public, and should be further investigated by Congress.

Arthur Young & Co. is the accounting firm hired last year by Peat, Marwick, Mitchell & Co. to provide an "independent" review of the firm's quality of practice. Arthur Young & Co. concluded after its review that Peat, Marwick, Mitchell & Co. had appropriately comprehensive quality control procedures. It also was "favorably impressed" with Peat, Marwick, Mitchell & Co.'s commitment to conduct its practice in accordance with professional standards. As described subsequently, the SEC had found multiple cases of improper and faulty auditing by Peat, Marwick, Mitchell & Co. (See Appendix C, p. 736.)

The Wall Street Journal recently reported that Pullman Inc. used Arthur Young & Co., its independent auditor, as a conduit for making questionable payments overseas. Arthur Young & Co. became involved in the affairs of Pullman Inc. by passing $5,000 to a foreign taxpayers' association, "presumably" for the purpose of bribing tax officials in that foreign country. (See Appendix C, p. 665.)

Partners of Arthur Young & Co. have made disturbing public statements regarding the proper role of independent auditors. In an interview with Forbes magazine, one top partner stated that independent auditors should not be expected to discover multi-million dollar slush funds, that independent auditors report to corporate managements and have little responsibility to the board of directors and the public, that independent auditors should have a "positive" attitude about using "imaginative" accounting methods for clients so that they will not be regarded as a "no" fellow by a client's management, and that the independent auditing relationship should be used to market management advisory services to clients. (See Appendix C, p. 663.)

Another top Arthur Young & Co. partner has stated that the real problem with business ethics concerning illegal bribery of foreign officials is that the Federal Government has not given businessmen prior guidelines on the type of illegal bribes which will be accepted as proper in reporting to the public. Without such guidelines, businessmen are unfairly deprived of knowing when it is all right to commit illegal bribery abroad. (See Appendix C, page 664.)

COOPERS & LYBRAND

The response of Coopers & Lybrand to this subcommittee's information request is included in Appendix C at page 666. The index to materials submitted indicates the type of activities in which the firm has engaged.

One example of Coopers & Lybrand's promoting the interests of its clients on controversial issues is the firm's comments to the Federal Power Commission (FPC) regarding the treatment of income taxes in setting rates for electricity. (See Appendix C, page 674.) After noting that the firm is the independent auditor for several electric utilities, Coopers & Lybrand advocates the use of "normalized" accounting for taxes which increases the cash flow of the firm's electric utility clients at the expense of customers using electricity. Coopers & Lybrand quotes with approval statements by the AICPA and the President's Labor-Management Committee which support the use of rate-making methods to increase the cash flow of electric utilities.

The Coopers & Lybrand comments also state that money paid by electricity customers for Federal income taxes which are not paid by electric utilities is really a donation by the Federal Government. rather than by the customers. This subcommittee has conducted research showing that electricity customers are often charged substantial amounts for Federal income taxes which are never paid to the Federal Government by electric utilities. As a result, customers of those utilities have been substantially overcharged, despite the claims of Coopers & Lybrand to the contrary.

In another letter of comment to the FPC, the firm supported the inclusion of construction work in progress in the rate bases of utilities. as well as the use of more generous earnings allowances for utilities. Adoption of the Coopers & Lybrand proposals would result in higher rates for customers. Use of such accounting procedures can raise electricity rates substantially without alerting customers to the ways in which they are being overcharged. Thus, the use of complex accounting procedures, such as those advocated by Coopers & Lybrand, have been strongly promoted by electric utilities in recent years.

Although Coopers & Lybrand acts as independent auditor for regulated utilities, the firm has instructed certain regulatory commissions on how to set utility rates. Customers in those jurisdictions may be subject to overcharges, based on the type of rate-making standards it has advocated before the FPC. Independent auditors cannot properly be involved in enriching regulated utilities at the expense of utility customers.

Coopers & Lybrand was also the auditor for a number of corporations whose insolvencies led to severe criticism of the firm's practices. These included Mill Factors Corp., R. Hoe & Co., International Controls Corp., and Continental Vending Machine Corp. In the latter case, two Coopers & Lybrand partners and one manager were indicted and convicted for fraud.

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ERNST & ERNST

The response of Ernst & Ernst to this subcommittee's request for information is included in Appendix C, at page 686. As shown by the index to materials submitted, many of the firm's activities are clearly incompatible with its position as an independent auditor.

One example is its letter of comment to the Cost Accounting Standards Board (CASB) regarding a CASB proposal to recognize a portion of government contractors' profits as a "cost" to be charged to the Federal Government. That proposal has since been adopted by the five-member CASB which includes a partner of Ernst & Ernst. The firm supported the CASB proposal, but was concerned that it did not go far enough. (See Appendix C, page 695.)

In its letter to the CASB, the firm advocated establishment of alternative, contradictory accounting definitions for the purpose of charging more costs to the Federal Government while reporting greater profits to the public. The letter states:

> We are in general agreement with the concept that the cost of capital should be recognized as an explicit cost of a contract, and that a contractor need not record this cost in his accounting records for financial statement purposes since this concept is not now recognized as a generally accepted accounting principle and may never be so recognized.

The Ernst & Ernst letter also argues for a higher rate to compensate contractors, a larger base to which the rate would apply, and the consideration of more accounting methods to compensate for "costs" that are not actually incurred.

The readiness of "Big Eight" accounting firms to promote alternative accounting systems for the purpose of guaranteeing profits of their corporate clients illustrates the poor chance of establishing uniform and meaningful accounting standards under the leadership of the "Big Eight" firms. In this particular case, Ernst & Ernst was advocating the use of "costs" which are not normally recognized as costs at all for the sole purpose of increasing contractor charges to the Federal Government. A variable definition of "costs" may benefit the corporate clients of Ernst & Ernst, but it hinders the development of efficient and proper accounting practices by the Federal Government.

Another example of activities by Ernst & Ernst is the study it performed for the State of Kentucky on the propriety of fuel adjustment clauses used by electric utilities. The major findings of that voluminous study are summarized in the letter of transmittal from the firm to the chairman of the committee which authorized the study. (See Appendix C, page 692.)

The Ernst & Ernst study recommended that fuel adjustment clauses should continue to be used by electric utilities in Kentucky. The study found that there was evidence of hard bargaining for the best fuel prices by the utilities, and that there are strong incentives to seek the best fuel prices, even though the costs are automatically passed to consumers. It should be noted that the firm's findings are contrary to the evidence presented to Congress during extensive hearings on the use of automatic fuel adjustment clauses.

The findings of the Ernst & Ernst study may be explained by the firm's overall work plan described in the letter of transmittal. Ernst & Ernst met with representatives from the various electric utilities, then had the initial drafts of its recommendations reviewed by the utilities to assure that the study's recommendations and presentations were "accurate and factual." Apparently, the firm did not meet with customers and consumer groups which might oppose use of fuel adjustment clauses, nor did the firm review its findings with such groups to assure accuracy.

The House Legal and Monetary Affairs Subcommittee has criticized Ernst & Ernst for the poor quality of work performed by the firm for the Federal Law Enforcement Assistance Administration. A newspaper account detailing the findings against Ernst & Ernst is included in Appendix C, at page 699.

A final example of the activities of Ernst & Ernst is a recent corporate tax reduction proposal by the firm to the FASB and the SEC. The proposal would permit corporations to adopt a simple "inflation accounting" method which would enable them to adjust asset values, increase depreciation charges, and pay lower Federal income taxes. Consistent with the previously described Ernst & Ernst comments to the CASB, the proposal on taxes would permit corporations to use a different accounting system for reporting to the public so that publicly reported corporate profits would not be reduced. Different accounting systems would be used to show different financial results to different parties, depending on the image a corporation might want to project. (See Appendix C, page 700.)

HASKINS & SELLS

The response of Haskins & Sells to this subcommittee's request for information is included in Appendix C, at page 701. The index to materials submitted indicates the scope of activities undertaken by that firm.

Haskins & Sells was involved in the auditing failures which allowed the famous fraud at Equity Funding Corp. of America to continue undetected. The trustee in bankruptcy for Equity Funding Corp. has found that Haskins & Sells "must share significant responsibility for the persistence of the fraud at Equity Funding." Relevant excerpts from the trustee's report describing the fraud and the failures of the independent auditors are included in Appendix C, at page 704. Even a committee of the AICPA, which is controlled by the "Big Eight" firms, has found that proper application of auditing standards would have uncovered the fraud at Equity Funding. (See Appendix C, page 726.)

The quality of auditing and management advisory services provided by Haskins & Sells was the subject of criticism and litigation resulting from the failures of four stock brokerage firms—Dempsey-Tegeler, Francis I. du Pont & Co., Orvis Brothers & Co., and Hayden Stone—which were clients of Haskins & Sells.

The firm has also been active as a partisan advocate for the interests of electric utility monopolies. Several of the Nation's largest electric utilities hire Haskins & Sells as their independent auditor.

Representatives of Haskins & Sells have promoted controversial rate-making methods to benefit utilities in several parts of the Nation.

In Florida, Haskins & Sells represented the electric utilities to lobby against a bill in the State legislature which would have permitted utilities to charge customers only for the amount of taxes actually paid to the government. In New York, the firm appeared at a public hearing held by the Federal Power Commission to argue that construction work in progress should be included in electric utility rate bases.

An excellent summary of the partisan positions taken by Haskins & Sells on behalf of electric utilities is provided by the discussion outline on "regulatory reform" prepared by Haskins & Sells for the AICPA's White House conference on 2 July, 1975. (See Appendix C, page 727.) The "regulatory reform" recommended includes giving electric utilities more profits through greater returns on equity, as well as making basic changes in accounting methods to achieve greater cash flow for utilities. All of the "reforms" advocated by Haskins & Sells would result in higher electric rates for consumers.

PEAT, MARWICK, MITCHELL & CO.

Peat, Marwick, Mitchell & Co. appears to be the largest of the "Big Eight" accounting firms in terms of revenue and operations. Its response to this subcommittee's request for information is included in Appendix C, at page 730. The materials submitted concerning its activities would appear to show a relatively minor amount of questionable or improper activities by the firm.

Along with Arthur Andersen & Co. and Touche Ross & Co., Peat, Marwick, Mitchell & Co. is one of three "Big Eight" firms which have been officially disciplined by the SEC for faulty auditing practices. The SEC issued its criticism of Peat, Marwick, Mitchell & Co. in Accounting Series Release 173. (See Appendix C, page 736.) Accounting Series Release 173 covers improper auditing practices by Peat, Marwick, Mitchell & Co. in five separate cases, and provides a detailed description of some different types of auditing abuses by "Big Eight" firms. The five cases described involve Penn Central Co., Republic National Life Insurance Co., Talley Industries Inc., National Student Marketing Corp., and Stirling Homex Corp.

Peat, Marwick, Mitchell & Co. was the first "Big Eight" firm to hire another "Big Eight" firm to review the quality of its practice. Arthur Young & Co. was hired to perform the review. According to news reports, Peat, Marwick, Mitchell & Co. paid $500,000 for its review. Not surprisingly, Arthur Young & Co. produced a favorable opinion on the quality of practice by Peat, Marwick, Mitchell & Co. about four months after the SEC issued Accounting Series Release 173. (See Appendix C, page 788.)

One example of questionable activities by Peat, Marwick, Mitchell & Co. is the firm's testimony before the House Ways & Means Committee on behalf of an oil and gas company. The testimony advocates tax benefits for oil and gas companies, and recommends that intangible drilling expenses be allowed as deductions for producing wells, in addition to dry wells. (See Appendix C, page 732.)

PRICE WATERHOUSE & CO.

As noted by the study prepared for this subcommittee by the Library of Congress, Price Waterhouse & Co. is the most influential "Big Eight" accounting firm because it acts as the independent auditor for a great number of the largest corporations in the United States. Its response to this subcommittee's request for information is included in Appendix C, at page 789. Price Waterhouse & Co. and Arthur Andersen & Co. were the only two "Big Eight" firms that cooperated fully in providing information requested by this subcommittee.

The index to materials submitted by Price Waterhouse & Co. shows that the firm is actively involved in a variety of questionable activities. The firm has taken partisan positions on controversial issues to promote its own interests, the interests of corporate clients, and the interests of private business groups. It has promoted its views before Congress, State legislatures and regulatory authorities.

A Price Waterhouse & Co. partner who serves as a director of the United States Chamber of Commerce recently appeared before the Senate Government Operations Committee on behalf of the Chamber of Commerce. He presented the Chamber of Commerce views on regulatory reform, which generally represent the views of large corporations that are often clients of his firm. (See Appendix C, page 796.)

The quality of practice at Price Waterhouse & Co. is also subject to question as a result of charges by the SEC of illegal and improper activities by General Tire & Rubber Co. Price Waterhouse & Co. is the independent auditor for General Tire. The scope of alleged improper or illegal activities by General Tire which were either not found or not required to be disclosed by Price Waterhouse & Co. is described in a *Wall Street Journal* article. (See Appendix C, page 810.)

A relevant excerpt from the news article summarizes the SEC charges against General Tire:

> The complaint—the broadest against any company since the SEC began its foreign payoffs investigations over a year ago—charges the concern with making illegal political contributions in the U.S., paying "gratuities" to military and civilian employees of U.S. agencies with which General Tire does business, overseas bribes, violation of foreign-currency laws, unrecorded "slush funds" and overbilling of foreign affiliates for supplies.
>
> Further, the company and its president, Michael Gerald O'Neill, are accused of setting up and maintaining for many years elaborate schemes to get around the laws of the U.S. and various foreign countries.

In another case, Price Waterhouse knew of a $1,250,000 bribe paid by a client, United Brands Co., to a Honduran official, but did not require that the bribe be disclosed in the financial statements of United Brands. The details of the Price Waterhouse & Co. decision are contained in a *Wall Street Journal* article in Appendix C, at page 809.

A special review of Gulf Oil Corporation ordered by the SEC also raised serious questions regarding Price Waterhouse & Co.'s audit of Gulf's internal controls and foreign subsidiaries over a period of 15 years.*

TOUCHE ROSS & CO.

The response of Touche Ross & Co. to this subcommittee's request for information is included in Appendix C, at page 812. More than any of the other "Big Eight" firms, Touche Ross & Co. has requested confidentiality for its response and refused to provide certain information to this subcommittee. The views of the firm regarding the amount and type of information which should be made available to the public on major accounting firms illustrate the need for a requirement that the "Big Eight" and other influential national accounting firms report periodically to the Federal Government.

Touche Ross & Co. is one of the three "Big Eight" firms which has been officially criticized by the SEC for improper auditing practices. In Accounting Series Release 153, the SEC described the firm's faulty auditing practices with regard to its audit of U.S. Financial, Inc. The SEC recently charged Touche Ross & Co. with violating proper auditing standards in two more cases. (See Appendix C, page 820.)

The index to materials submitted by Touche Ross & Co. shows that the firm is very active in testifying before State regulatory commissions in utility rate cases. As such, it has supported controversial ratemaking procedures which benefit utilities at the expense of consumers. The firm has also testified concerning the amount of profits which utilities should earn.

Influence of the "Big Eight" Accounting Firms On Federal, State, and Local Governments

This section describes primarily the contractual and direct relationships "Big Eight" firms have with governmental authorities. Because of their broad scope of services, "Big Eight" accounting firms have the Federal Government and many State and local governments as clients. The "Big Eight" firms perform services for their governmental clients on a fee basis, just as they do for clients in the private sector. Sometimes "Big Eight" firms provide their opinions to the Federal Government voluntarily.

Other means of influence are described in different sections of this study. For example, the "Big Eight" firms directly and actively influence government authorities through public statements, testimony before legislative and regulatory bodies, and lobbying efforts. Those very influential activities are described in sections of this study dealing with the independence and activities of individual "Big Eight" firms. (See pp. 48 and 54.)

As noted previously, the "Big Eight" accounting firms exercise extensive indirect influence on government authorities through their clients and through other private organizations. Many of these activities are described in sections of this study dealing with the AICPA, the FASB, and the activities of individual "Big Eight" firms.

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* Report of the Special Review Committee of the Board of Directors of Gulf Oil Corporation (December 30, 1975); *SEC v. Gulf Oil Corp. and Claude C. Wild, Jr.*, Civil Action No. 75–0324, U.S. District Court (D.C.).

This subcommittee requested certain information concerning government clients in its December 19, 1975 questionnaire to the "Big Eight" accounting firms. Their responses are included in Appendix A. Reference should be made to those responses for complete information on the subjects described.

The "Big Eight" firms were asked to identify the agencies and departments of Federal, State, and local governments that are their clients. The lists of governmental clients are generally quite extensive. Some of the "Big Eight" firms are more active than others in seeking governmental clients, as shown by the client lists.

Table I on page 30 summarizes the information on the percentage of "Big Eight" firm revenues derived from performing services for Federal, State, and local governments. Touche Ross & Co. requested that its response be kept confidential, but the table shows that the percentage of revenues received from governmental clients by the other "Big Eight" firms runs from one percent for Ernst & Ernst to between five and 10 percent for Arthur Young & Co. Although the percentages are low, the actual amount of revenues received from governmental clients is substantial for some "Big Eight" firms because their total revenues are very large.

The "Big Eight" firms perform a broad range of services for governmental clients. Many of the services performed for State and local governments are auditing and accounting services to determine the financial status of those governments and their programs. Services performed for the Federal Government include management advisory services.

The "Big Eight" accounting firms derive multiple benefits from performing services for governmental clients, not the least of which are the substantial revenues they receive. When performing auditing and accounting services, "Big Eight" firms wield the customary influence of independent auditors over their clients. They are intimately involved in the application of auditing and accounting methods which may determine whether a tax increase is necessary, or whether municipal bonds may be sold prudently. Like most clients, governments respect the judgments of their independent auditors.

Performance of services for governmental clients may also present "Big Eight" firms with an opportunity to benefit private clients. In order to influence the direction of government policies and programs, many private groups would undoubtedly advise governmental authorities at no charge. However, the "Big Eight" firms have the double benefit of influencing governmental authorities while being paid for their advice.

There are conflicts of interest involved because much of the advice provided to government agencies and departments by "Big Eight" firms directly or indirectly affects their corporate clients. Clients operating in industries such as air transportation, communications, or electric utilities are affected by policies and procedures adopted by Federal and State regulatory authorities which are also clients of "Big Eight" firms.

One recent example of the type of advice given to Federal agencies by "Big Eight" firms is a Price Waterhouse & Co. study of the accounting policies which should be applied to cable television operators

by the Federal Communications Commission (FCC).* A major recommendation of the study is that "precise accounting standards are not necessary to satisfy the FCC's present requirements." Instead, the study recommends that the FCC accept any of the alternative accounting standards that are permitted by the private sector's standard-setting bodies.

Standard-setting bodies in the private sector have always been controlled by the AICPA, which is controlled by the "Big Eight" accounting firms. A uniform system of meaningful accounting standards has never been developed in the private sector. Influential corporate clients of the "Big Eight" firms have insisted on retaining alternative accounting standards to permit them great flexibility in reporting corporate earnings. The Price Waterhouse & Co. study recommends that the FCC not establish uniform accounting standards which would restrict the flexibility of cable television operators in reporting the amount of profits they earn, even though the private sector has failed to establish uniform standards.

Another example of consulting work by "Big Eight" firms is a report prepared by Coopers & Lybrand for the Department of Defense concerning the adequacy of profits earned by defense contractors. For its "Profit '76" study, the Department of Defense wanted to determine the attitudes of contractors toward defense procurements. Coopers & Lybrand, which has major defense contractors as audit clients, found that defense business is riskier than commercial business, and that Federal procurement regulations are unnecessarily complex and demanding.

This subcommittee requested the amount of revenues received by "Big Eight" firms for services to the Federal Government in each of the past six years. Their responses are summarized in Table I on page 30. The Touche Ross & Co. revenues from Federal contracts are not revealed in that table because the firm asked that its figures not be separately disclosed.

The total revenues received by the "Big Eight" firms from the Federal Government in each of the past six years are as follows:

1970	[1] $2,427,000
1971	8,037,000
1972	11,635,000
1973	14,197,000
1974	15,164,000
1975	16,486,000

[1] Arthur Andersen & Co. and Peat, Marwick, Mitchell & Co. did not submit data for 1970.

The amount of revenues received by these firms from the Federal Government has increased substantially in recent years, indicating that the amount of services performed for the Federal Government has increased. (It should be noted that Federal contract revenues received by individual "Big Eight" firms do not correspond exactly to the percentage of their revenues received from government clients. The percentage figures shown in Table I include revenues from State and local governments, as well as the Federal Government.)

* Contract FCC–0177, "Study of Accounting Policy Issues and Other Considerations Related to the FCC Cable Bureau's Financial Reporting System for Cable Television Operators," submitted June 7, 1976.

An example of the "free" advice given to the Federal Government by "Big Eight" firms is the testimony of representatives from Arthur Andersen & Co. and Price Waterhouse & Co. before the Special Subcommittee on Integrated Oil Operations of the Senate Committee on Interior and Insular Affairs on 21 February, 1974. Their prepared testimony was presented for the purpose of describing the differences between "full costing" and "successful efforts" accounting methods as applied by oil and gas companies. (See Appendix C, page 632.)

Arthur Andersen & Co. and Price Waterhouse & Co. both act as independent auditors for major corporations involved in oil and gas production. As such, both firms are supposed to remain independent from the interests of their clients. Rather than declining to respond to any questions which might affect their firms' ability to remain independent, the representatives of Arthur Andersen & Co. and Price Waterhouse & Co. freely advocated the controversial views generally expressed by managements of oil and gas companies.

In response to questioning, both firms' representatives stated that the 30 largest integrated oil companies are competitive, that the Federal Power Commission has restricted the supply of natural gas through its pricing policies, and that oil and gas prices are being kept too low by Congress. Those views are controversial, and do not fall within the expertise associated with independent auditing. Nevertheless, the representatives from Arthur Andersen & Co. and Price Waterhouse & Co. went on record advocating politically and factually controversial positions before Congress on issues of great importance to the managements of their corporate clients in the oil and gas business.

The "Big Eight" accounting firms provide extensive services to Federal, State, and local governments. They are able to directly influence the course of governmental policies and programs through performance of their services. Conflicts of interest occur when "Big Eight" firms influence governmental authorities on matters which affect their corporate clients. The "Big Eight" firms have been able to spread the scope of their influence across both the public and private sectors.

Quality of Practice by "Big Eight" Accounting Firms

Application of proper accounting and auditing procedures by "Big Eight" firms is vitally important to the Nation's economy and the public's welfare. The effects of mistakes and improper practices by these firms are amplified because their big corporate clients are large enough to have substantial impact on the Nation's economy. To the extent that large corporations are able to pursue improper or illegal activities through the use of deceptive accounting practices, the public is dependent upon the "Big Eight" accounting firms for protection against the use of such harmful practices.

Public realization of defective accounting and auditing practices by "Big Eight" firms has too often come only after investors, creditors, suppliers, customers, and others have suffered severe financial losses. Many examples of improper, faulty, and incomplete accounting and auditing practices have been brought to public attention.

Dr. Abraham J. Briloff has documented and clearly explained the accounting abuses by "Big Eight" firms in two revealing books.* He summarized his research on accounting abuses in testimony before the Subcommittee on Oversight and Investigation of the House Committee on Interstate and Foreign Commerce on 21 May, 1976.

His statement before the House Subcommittee on Oversight and Investigation appears in Appendix K, page 1609. Reference should be made to Professor Briloff's statement for a comprehensive description regarding the quality of practice by "Big Eight" accounting firms.

Four of the firms have already been cited for abusive accounting practices through actions in the courts and by the SEC. The SEC formally disciplined three firms through issuance of accounting releases. Those firms are Arthur Andersen & Co., Peat, Marwick, Mitchell & Co., and Touche Ross & Co. The SEC disciplinary reports are referenced in the section of this study describing activities of individual "Big Eight" firms. (See page 54.)

The trustee in bankruptcy for Equity Funding Corporation of America has found that Haskins & Sells "must share significant responsibility for the persistence of the fraud at Equity Funding." Relevant excerpts from his report are referenced in the section of this study on Haskins & Sells. (See page 61.)

The problems resulting from defective audits by "Big Eight" firms derive in large part from their lack of independence as auditors. Information received by this subcommittee generally confirms that the first loyalty of these firms is to the managements of corporate clients who retain them and authorize payment of their fees.

During conversations with the subcommittee staff, representatives of "Big Eight" firms and the AICPA have argued that independent audits of large corporations cannot be expected to provide real assurance that corporate financial statements are accurate. The leadership of the AICPA has advocated that the public should not expect too much from independent auditors of corporations. In line with that view, the AICPA is considering proposing Federal legislation which would limit the legal liability of independent auditors in civil court suits, and protect CPAs from the consequences of their negligence.

As described in subsequent sections of this study dealing with the AICPA, the "Big Eight" firms and the AICPA have been instrumental in helping to convince the public that independent auditors can affirm the accuracy of financial and other types of information. Although they have complained that they are powerless to prevent abuses by corrupt corporate managements, they have opposed legislation that would provide criminal sanctions against corporate executives who deliberately mislead independent auditors.

The position of the AICPA and the "Big Eight" firms is that multimillion dollar sums are immaterial to the operations of major corporations, and that independent auditors should not be expected to account accurately for such sums. (See page 121.) That view ignores the fact that multimillion dollar sums are very material in their absolute impact on individuals and certain segments of the economy. Paradoxically, the AICPA and the "Big Eight" accounting

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* Briloff, Abraham J.: "Unaccountable Accounting," Harper & Row, New York, N.Y. (1972); "More Debits Than Credits," Harper & Row, New York, N.Y. (1976).

firms advocate a lower level of accountability as corporations grow larger.

Large organizations increase the opportunity for improper activities by corporate personnel. As described subsequently (see page 101), the answer of the AICPA and the "Big Eight" firms to the problem of corporate accountability is to lower the expectations of Federal officials and the public through legislative and publicity campaigns to re-educate the public.

The real need is to improve independent auditing capabilities so that the public, as well as concerned corporate managers, can be assured that corporate accounts are accurate.

CHAPTER II. ORGANIZATION OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Introduction

As previously mentioned, the AICPA is the preeminent professional organization in the field of accounting. Other than the Federal agencies and State boards of accountancy which hold the ultimate authority to determine accounting matters, the AICPA is the most powerful and influential force in shaping the environment in which accountants operate.

The AICPA has extended its power and influence beyond its position as the dominant private accounting organization through close relationships with Federal agencies and State boards of accountancy that regulate the accounting profession. The dependence of those governmental agencies upon the information and activities of the AICPA is the key to its extraordinary and continuing influence.

The organization and procedures of the AICPA are a primary reason for its position of power. The AICPA is presently organized to reflect and effectively project the interests of the most powerful accounting firms—the "Big Eight"—and, to some extent, the next seven largest accounting firms.

This organizational focus has benefitted the AICPA by permitting a more easily identified sense of purpose, while also providing the necessary resources to accomplish its goals. The coordination of purpose with resources—which strengthens the AICPA as an organization—is possible because of the vast amount of wealth and influence controlled by a small number of very large accounting firms. If the same amount of wealth and influence were apportioned among a greater number of accounting firms, the community of interest guiding the actions of the AICPA would be significantly reduced, and its organizational purpose would probably become more diffused as a consequence.

The organizational structure of the AICPA permits a dominant role for the "Big Eight" and next seven largest accounting firms. It also ensures a stable transition of power so that those persons managing the organization have great control over the selection of the persons who will come into power.

The maintenance of power over the AICPA by the persons presently in control is illustrated by the description of the Nominations Committee in the 1975–76 AICPA Committee Handbook. The stated objective of the Nominations Committee, which plays an important part in the transfer of power, is "to provide for continuity of leadership and add distinction to the organization by nominating the best of the profession for officers, Council and the Board of Directors." Continuity of policy and perspective requires organized procedures for the selection of like-minded nominees for positions of influence.

The Nominations Committee is instrumental in selecting the members for five of the six membership groups comprising the AICPA council. Those five groups in fiscal 1976 accounted for 198 of the 252 council members, or 79 percent of the council membership. In turn, as explained subsequently, the Nominations Committee is confirmed by the council.

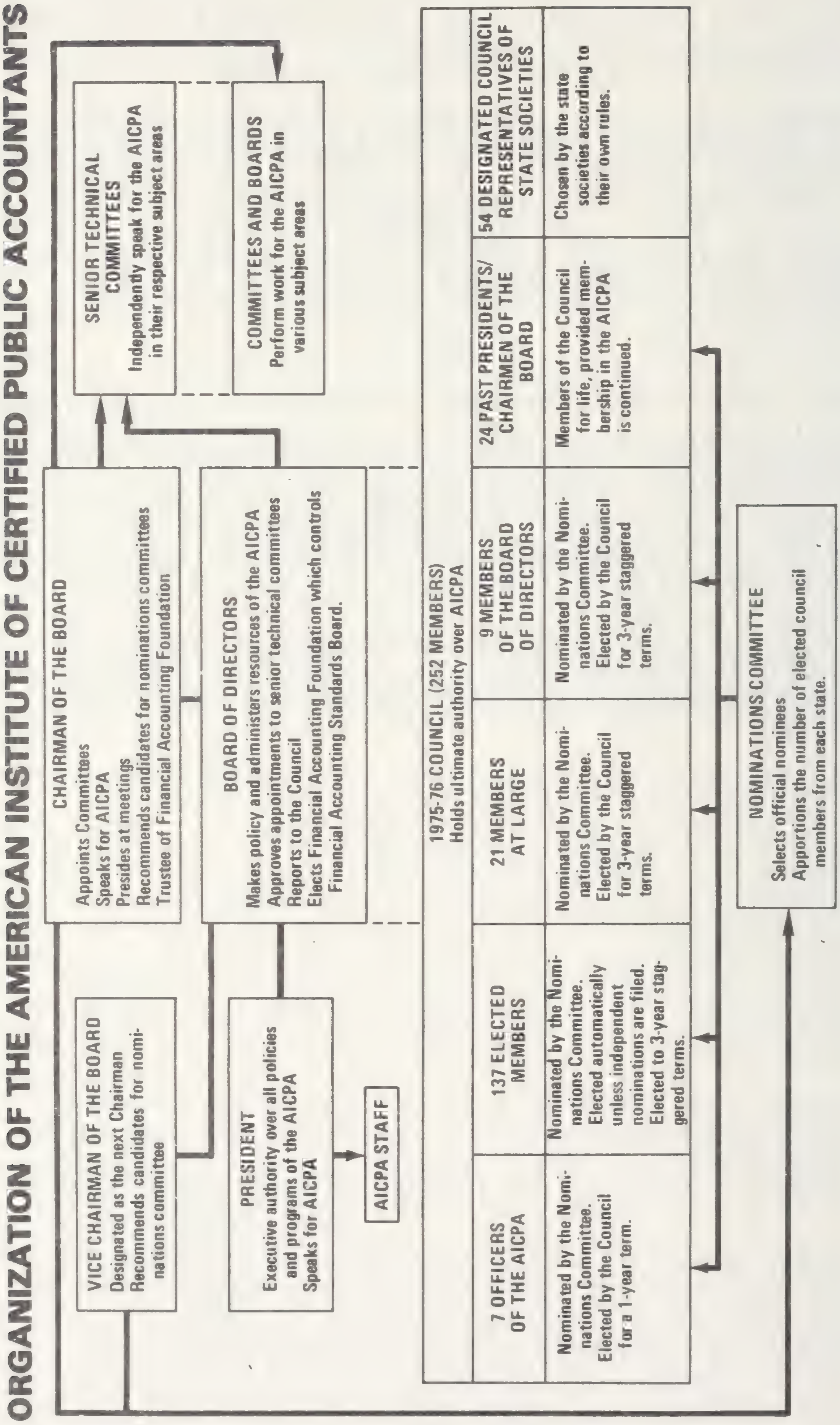
The following is an analysis of the AICPA bylaws which govern its procedures. The analysis shows an array of procedural techniques for maintaining the *status quo* regarding control of the AICPA and its activities. From a purely organizational viewpoint, the persons presently controlling the AICPA are in the most favorable position to exercise the procedural tools for their continuing benefit.

Council

The council is the basic body for exercising the powers of the AICPA, including the authority to prescribe its policies and procedures, and to enact resolutions binding upon the board of directors, officers, committees, and staff. During fiscal 1976, the council was comprised of 252 members. The membership should decline soon to about 200 when the number of elected members is reduced from 137 to 85 as required in the bylaws. The council meets twice a year to perform its functions.

The council is comprised of six membership groups, each of which is selected by different methods (see Chart 2 on following page). Each council member is entitled to one vote regardless of his method of selection.

CHART 2


ORGANIZATION OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
VICE CHAIRMAN OF THE BOARD
Designated as the next Chairman
Recommends candidates for nominations committee
CHAIRMAN OF THE BOARD
Appoints Committees
Speaks for AICPA
Presides at meetings
Recommends candidates for nominations committees
Trustee of Financial Accounting Foundation
SENIOR TECHNICAL COMMITTEES
Independently speak for the AICPA in their respective subject areas
COMMITTEES AND BOARDS
Perform work for the AICPA in various subject areas
PRESIDENT
Executive authority over all policies and programs of the AICPA
Speaks for AICPA
AICPA STAFF
BOARD OF DIRECTORS
Makes policy and administers resources of the AICPA
Approves appointments to senior technical committees
Reports to the Council
Elects Financial Accounting Foundation which controls Financial Accounting Standards Board.
1975-76 COUNCIL (252 MEMBERS)
Holds ultimate authority over AICPA
7 OFFICERS OF THE AICPA
Nominated by the Nominations Committee. Elected by the Council for a 1-year term.
137 ELECTED MEMBERS
Nominated by the Nominations Committee. Elected automatically unless independent nominations are filed. Elected to 3-year staggered terms.
21 MEMBERS AT LARGE
Nominated by the Nominations Committee. Elected by the Council for 3-year staggered terms.
9 MEMBERS OF THE BOARD OF DIRECTORS
Nominated by the Nominations Committee. Elected by the Council for 3-year staggered terms.
24 PAST PRESIDENTS/ CHAIRMEN OF THE BOARD
Members of the Council for life, provided membership in the AICPA is continued.
54 DESIGNATED COUNCIL REPRESENTATIVES OF STATE SOCIETIES
Chosen by the state societies according to their own rules.
NOMINATIONS COMMITTEE
Selects official nominees
Apportions the number of elected council members from each state.

The five groups whose members serve on the council as a result of selection by the Nominations Committee are the officers, elected members, members at large, members of the board of directors, and past presidents/chairmen of the board.

OFFICERS

Seven of the eight officers of the AICPA are council members as required in the bylaws. Only the secretary is excluded, and he is not required to be a member of the AICPA as are the others. All of the officers are elected by the council by majority vote. Six officers are nominated by the Nominations Committee. The president and secretary, both full-time and salaried, are recommended to the council by the board of directors.

The Nominations Committee nominates the chairman of the board, vice chairman of the board, three unpaid vice presidents (termed volunteers) and the treasurer in advance of the council meeting. No nominations are permitted from the council floor at the meetings where elections are held. This procedural technique prevents election of officers due to aroused feelings or personal lobbying which may occur at a council meeting. Continuity of leadership is maintained through this procedure.

Independent nominations may be made by any 20 members of the council, if filed with the secretary at least four months prior to the annual meeting of the AICPA. As the Nominations Committee publishes its nominees to the membership at least five months prior to the annual meeting, this process allows ample time for all parties to develop support for their nominees, and avoids surprises which may be detrimental to continuity of leadership.

All of the officers serve one-year terms, except the president and secretary. They are paid employees of the AICPA and serve unlimited terms. Only the treasurer may succeed himself.

According to the bylaws, the chairman of the board has the widest individual authority within the AICPA. He presides at meetings of the AICPA membership, the council, and the board of directors. He appoints the members of committees and boards, as well as determining the duties, powers, responsibilities, and procedures of the committees and boards. The power to appoint committees is very significant since most of the AICPA's activities are handled by committees. The chairman also acts as spokesman for the AICPA and appears on its behalf before other organizations.

Under the bylaws, the vice chairman is designated as the next chairman of the board, a provision which ensures stability and continuity in the most powerful position in the AICPA. Everyone knows who the next chairman will be a year in advance, and there is ample time to confirm that he will continue existing policies upon assuming power. The vice chairman also presides at meetings in the absence of the chairman and familiarizes himself with the duties of chairman.

The three elected vice presidents perform various duties assigned to them, and one is designated to preside at meetings of the AICPA membership or the council when the chairman and vice chairman are absent.

The treasurer handles financial matters and advises the board of directors on such affairs. The secretary performs the normal duties of corporate secretary.

Second only to the chairman in authority is the president, who has full charge of the AICPA's daily affairs. The bylaws give the president full responsibility for the execution of policies and programs of the AICPA. He is also designated as a spokesman for the organization and controls its staff. As noted previously, the president is salaried and serves an indefinite term.

ELECTED MEMBERS

The second—and the largest—membership group within the council is the elected members. The bylaws require that each State with one or more members in the AICPA have at least one representative on the council directly elected by the membership of that State's professional CPA society.

The number of directly elected council representatives from each State is determined by the Nominations Committee on the basis of the number of AICPA members from each State. There were 137 elected members on the fiscal 1976 council, but that number will diminish to 85 in future years due to the departure of existing elected members whose terms were not affected by the size limitations required in the bylaws.

Although this group of council members is elected by a majority of the votes cast in each State society election, the procedures by which candidates are nominated and elected gives great control over the selection process to the AICPA's Nominations Committee. At least eight months prior to the annual meeting of the AICPA, the Nominations Committee requests two suggested candidates from a State society for each vacancy to be filled. The Nominations Committee then nominates the candidate it prefers at least six months prior to the meeting. The bylaws specifically state that the Nominations Committee "shall give due consideration to the names so submitted, but shall not be required to select its nominees from among such names. In the absence of a satisfactory response from any such state society, the Nominations Committee shall select the nominees from such state."

This important provision means that the Nominations Committee can contravene the wishes of a State society as to who should be the official nominee from that State if the State society attempts to nominate someone who is unacceptable to the Nominations Committee. The ability of the AICPA's Nominations Committee to influence or even decide who represents State societies is even more substantial because of the automatic election provision for unopposed official nominees.

The nominees of the Nominations Committee are automatically declared elected by the secretary if no independent nominations are filed. Thus, the official nominees of the Nominations Committee have a great advantage in being elected to serve on council.

Independent nominations may be made by any 20 AICPA members from a State where an election is to be held, but such nominations must be filed with the Secretary at least four months prior to the annual meeting of the AICPA.

If independent nominations are properly filed, then the secretary mails ballots to all AICPA members in that State at least 90 days

prior to the annual meeting of the AICPA. To be counted, ballots must be returned to the secretary at least 45 days before the annual meeting. A majority of the votes returned by that date is needed to elect a member to the council.

The process for choosing elected members for the council is similar to the election of officers, in that it avoids surprises at the annual meeting of the AICPA and gives a decided advantage to nominees chosen by the AICPA's Nominations Committee. Unlike the officers, however, the elected members are chosen in advance of the annual meeting.

Elected members of the council serve a three-year term with a limit of two consecutive terms. The terms are staggered so that approximately one-third of the elected members stand for election each year. This procedure is yet another way of preserving organizational stability and continuity.

MEMBERS AT LARGE

The third group of members on the council as a result of Nominations Committee influence is the members at large. The bylaws require that seven AICPA members be elected annually by the council without regard to their States of residence to serve as members at large on the council. Members at large serve three-year terms, so there are a total of 21 members at large represented on the council. Consecutive terms are limited to two.

The members at large are nominated and elected in the same manner as the officers of the AICPA. They are elected by council after advance nomination by the Nominations Committee. Floor nominations are not permitted, but any 20 council members may make independent nominations in advance through the same procedures followed for independent nomination of officers.

Continuity of established policies is enhanced through the election of members at large because prominent members of the accounting profession may be elected to the council without regard to proportional representation based on AICPA membership in each State. Council representation of the elected members group is proportional, and a State like New York—which is a center of business and accounting—may not be able to elect all of its prominent State society members according to a strictly proportional system of council representation.

Electing members at large permits flexibility in having certain persons represented on council who are not otherwise included in the group of persons exercising the basic powers of the AICPA. For example, the managing partners of four of the "Big Eight" accounting firms were on the fiscal 1976 council through election as members at large, and six of the 21 members at large were from New York.

BOARD OF DIRECTORS

The fourth membership group on the council is the nine elected members of the board of directors. The bylaws provide that all members of the board are *ex officio* members of the council. The board of directors is nominated and elected under the same bylaw as the officers and members at large, so the Nominations Committee plays the same influential role in the board's selection. Advance nomination and election by the council ensure that the elected board members will

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reflect the prevailing views within the AICPA. Independent nominations in opposition to the Nominations Committee's slate of candidates are also restricted in the same manner as independent nominations for officers and members at large.

According to the bylaws, the board of directors includes nine present or former members of the council elected to the board to serve a three-year term. There is no limit to the number of terms which may be served by an individual, but consecutive terms are not permitted. Continuity is assured by having only one-third of the board elected each year. The staggered three-year terms for the board members are the same as for the elected members and members at large. The full board of directors plays an important part in the operations of the AICPA, as will be subsequently explained.

PAST PRESIDENTS AND BOARD CHAIRMEN

The fifth group of council members who serve as a result of Nominations Committee influence is the past presidents and chairmen of the board. The bylaws provide that all past elected presidents and chairmen of the board shall be council members for life, as long as they continue to be members of the AICPA. Although the chairman of the board is now the highest elected officer and the president is a paid employee, presidents of the AICPA were elected volunteers prior to January, 1974.

The Nominations Committee is responsible for nominating the officers who are then elected by council. All past presidents and chairmen of the board owe their current position on the council to their original nomination and election to office, so the Nominations Committee is very influential in the selection of this membership group.

On the fiscal 1976 council, there were 24 members who were past presidents or chairmen of the board, including one member who was also a member of the board of directors. The number of past presidents and chairmen of the board on council fluctuates according to individual lifespans and continued membership in the AICPA. Continuity of AICPA policies is obviously greatly enhanced by the continuing presence on council of individuals who previously held the top policy-making position.

DESIGNATED STATE REPRESENTATIVES

The sixth—and final—group of members on the council is the 54 designated council representatives of State societies. The bylaws provide that each State society may designate one of its members as its representative on the council according to any method the State society may deem appropriate. Representatives from professional accounting societies in U.S. territories and possessions are included in this group.

Designated council representatives of State societies serve one-year terms with a limit of six consecutive terms. The accepted practice is to designate the president of each State society as its council representative.

This is the only membership group on the council where the Nominations Committee does not influence the selection of council members. In that sense, it is the most democratic because the central power struc-

ture of the AICPA plays no official role in the nomination or election of this group of members on council. Continuity of AICPA policies is not institutionalized on the national level in the selection of designated council representatives of State societies. However, pressures for continuity may exist at the State level.

In summary, the council is the body charged in the bylaws with exercising the powers of the AICPA. The selection of new council members is basically a continuous process of partial replacement which assures that remaining council members, along with the officers and directors, will be able to control the direction of the AICPA. Because more than 78 percent of the council is nominated by the Nominations Committee, and the officers and board of directors are elected by the council itself, the existing council members have great influence over the selection of new council members. The entire process of choosing the council is one which promotes continuity of policies and maintenance of power by those persons or groups who currently control the AICPA.

Nominations Committee

The significant role of the Nominations Committee in the selection of five of the six membership groups on the council has been described. In addition, the Nominations Committee nominates the Trial Board—to be discussed subsequently—and allocates the number of elected council seats from each State.

The Nominations Committee implements continuity of policy because its seven members are elected by the council to serve that purpose. The bylaws require that two of the seven members of the Nominations Committee also be council members.

Who nominates the pivotal Nominations Committee? The bylaws provide that, at the council meeting preceding the annual meeting of the AICPA, the retiring chairman of the board and the incoming chairman shall present their joint recommendations for members of the Nominations Committee for the coming year. The fact that the retiring chairman and the incoming chairman—the two most powerful persons in the AICPA nominated by the Nominations Committee—are responsible for nominating the Nominations Committee may explain why the chairman of that committee is traditionally the immediate past board chairman of the AICPA. The circularity of the process ensures that the policies of the AICPA are continuous and reflect the prevailing views of those in control.

Board of Directors

Although the council is given the ultimate responsibility for exercising the powers of the AICPA, the bylaws provide that the board of directors shall act as the executive committee of the council and report to the council at least semiannually. The bylaws state that the board of directors "shall control and manage the property, business and activities of the AICPA, and shall take whatever action it deems desirable including the establishment of policies for the conduct of the affairs of the AICPA consistent with the provisions of these bylaws, resolutions of the membership, or actions of the Council."

The bylaws provide that the board of directors shall be composed of:

> The chairman of the board, the vice chairman of the board, the vice presidents elected by the council, the treasurer, and the immediate past chairman of the board;
>
> The salaried president and secretary of the AICPA; and
>
> Nine present or former members of the council elected to the board by the council.

As in other large organizations, the council has become a sounding board for the actions of the board of directors, the chairman of the board, and the president. The board is a smaller, more cohesive and effective group with the authority to act for the council on a regular basis. Meeting approximately once a month, the board works in conjunction with the chairman and the president to formulate the working policies and pursue the interests of the AICPA through specific projects and activities.

From the standpoint of daily operations, the board of directors, the full-time, salaried president and the top elected officers are in actual control of the AICPA and its activities. The council approves and reviews major policies, but is dependent on the board, the chairman, and the president for the initiation and presentation of specific proposals prepared by the AICPA staff. The board, along with the chairman and the president, is instrumental in the direction taken by the AICPA because it exercises both policy authority and management of the AICPA's staff and resources. Inclusion of the immediate past chairman on the board also serves to promote policy continuity by the board of directors.

Apart from its control over the AICPA, the board of directors exercises ultimate authority over the Financial Accounting Foundation (FAF) and the Financial Accounting Standards Board (FASB)—the "independent" body within the private sector responsible for setting accounting standards. The certificate of incorporation for the Financial Accounting Foundation specifically provides that the board of directors of the AICPA shall *ex officio* constitute the voting members of the FAF, which is a non-profit corporation. The organization of the FAF and the FASB is described in detail in another chapter of this study. (See pp. 138 (FAF) and 142 (FASB)).

The noteworthy point here is that whoever controls the AICPA's board of directors simultaneously maintains ultimate authority over the FAF and the FASB. The board of directors of the AICPA definitely plays a key role within the present framework of the accounting profession and the determination of accounting standards.

Committees and Boards

Much of the AICPA's work in specific areas of interest is accomplished by committees, subcommittees, and boards. The 1975–76 Committee Handbook of the AICPA lists 108 committees, subcommittees, and boards, ranging in membership from one to 43. Most of them have from five to 15 members.

A complete description of all the committees, subcommittees and boards and their memberships may be obtained from the AICPA Committee Handbook, which is published annually. A listing of all the committees, subcommittees, and boards, along with the membership of

"Big Eight" accounting firms on each one, is included in an appendix to this study. (See Appendix E, p. 1078.) It should be noted that committees, subcommittees, and boards are all distinct entities within the AICPA, and this study will refer to them in general as committees for the sake of convenience.

The bylaws provide that "the chairman of the Board, or his delegate, may appoint committees and boards with such duties, powers, responsibilities, and procedures as he may prescribe. The chairman of the Board, the president and the secretary shall have the privilege of the floor at meetings of all committees and boards." This provision assures that the activities and memberships of committees reflect the prevailing views of those in control of the AICPA.

SENIOR COMMITTEES

The council may designate any committee as a "senior" committee. Appointments by the chairman of the board to senior committees require approval of the board of directors. The duties, powers, responsibilities, and procedures of senior committees are prescribed by the council. This process guarantees that committees doing work in important areas will reflect the views of those in control of the AICPA.

Examination of the senior committees confirms that the truly important ones are those subject to board approval. They are:

- Accounting Standards Executive Committee;
- Auditing Standards Executive Committee;
- Board of Examiners;
- Federal Taxation Executive Committee;
- Management Advisory Services Executive Committee;
- Practice Review Committee;
- Continuing Professional Education Executive Committee, and Professional Ethics Executive Committee.

The quotations below regarding the objectives of these senior committees appear in the AICPA Committee Handbook.

Accounting Standards Executive Committee

The objective of the Accounting Standards Executive Committee is "to determine AICPA technical policies regarding financial accounting and reporting standards and generally to be the AICPA's official spokesman on those matters. This includes maintaining liaison with the Financial Accounting Standards Board and the Cost Accounting Standards Board, and issuance, as appropriate, of position papers on current accounting standards pending release of official interpretations by the FASB."

Auditing Standards Executive Committee

The Auditing Standards Executive Committee has the objective "to continue the development of auditing and reporting standards." Despite its brief description, this committee exercises tremendous influence because it is concerned with defining the proper role of the independent auditor.

Board of Examiners

The objective of the Board of Examiners is "to establish policy for the Examinations Division and to supervise, coordinate, plan, and

initiate all of the projects, programs and activities of the subcommittees and task forces of the Board of Examiners. Specific responsibilities of this committee are to prepare semi-annual uniform examinations in accounting theory, accounting practice, auditing and business law which may be used by state boards of accountancy for examining CPA candidates; to make available to state examining boards a uniform grading service; to provide state boards of accountancy with aids to candidates for the examination and to serve as liaison between the AICPA and the National Association of State Boards of Accountancy on matters pertaining to the examination."

Federal Taxation Executive Committee

The objective of the Federal Taxation Executive Committee is "to supervise, coordinate, plan and initiate all of the projects, programs and activities including budget appropriations of the 12 constituent Committees which comprise the Tax Division." The stated objectives of the constituent committees comprising the tax division are described in Appendix E, page 943. In general, each committee is "to formulate and submit to Congress, the Treasury Department and Internal Revenue Service technical and policy recommendations for improvement of the Federal tax process" relating to the areas covered by the committees. Those areas are:

Employee benefits;
Financial and estate planning;
International taxation;
Responsibilities in tax practice;
Scope and management of a tax practice;
Tax accounting;
Tax administration;
Tax determination;
Tax forms;
Tax policy;
Tax publications;
Taxation of corporate distributions and adjustments; and
Taxation of special entities and industries.

Management Advisory Services Executive Committee

The stated objective of the Management Advisory Services Executive Committee is "to assist practitioners in performing management advisory services consistent with appropriate professional competence, ethical standards, and responsibility; and to develop standards and guidelines for this area of professional practice."

Practice Review Committee

The objective of the Practice Review Committee is "to reduce deviations from acceptable reporting practice through education of practitioners as to the application of GAAP and practices in specific cases, and to encourage state societies in developing programs to deal with the problems at the local level in cooperation with bankers and other credit grantors." The bylaws provide that the Practice Review Committee can review specific audit reports of practitioners which appear to deviate from accepted standards, but its function is to be merely educational, not disciplinary, in nature. Furthermore, case referrals to the professional ethics division for disciplinary action are prohibited, and all dealings of the Practice Review Committee are to be confiden-

tial. This committee is not intended to aid enforcement of accounting standards in any manner.

Continuing Professional Education Executive Committee

The Continuing Professional Education Executive Committee's objective is "to establish policies and strategies for the projects, programs and activities of the constituent committees and the Continuing Professional Education Division." This committee is in charge of all matters relating to the requirement and substance of continuing professional education for practicing accountants.

Professional Ethics Executive Committee

Finally, the Professional Ethics Executive Committee has the objective "to develop standards of ethics, promote understanding and voluntary compliance with such standards, establish and present apparent violations of the standards and the AICPA's bylaws to the Joint Trial Board for disciplinary action, improve the profession's enforcement procedures, and coordinate the subcommittees of the Professional Ethics Division." This committee is the AICPA's policeman.

It can be seen that the areas of interest covered by the eight senior committees of the AICPA include all the substantive areas of accountancy. Because of the importance of areas in which the senior committees work, the bylaws assure that the membership of the senior committees shall represent the prevailing views of those persons who control the AICPA.

SENIOR TECHNICAL COMMITTEES

The bylaws provide that five of the eight senior committees are technical committees "authorized to make public statements, without clearance with the Council or the Board of Directors, on matters related to their area of practice." They are:

Accounting Standards Executive Committee;
Auditing Standards Executive Committee;
Federal Taxation Executive Committee;
Management Advisory Services Executive Committee; and
Professional Ethics Executive Committee.

This remarkable provision means that the five senior technical committees can act for the AICPA in the five most important areas of accounting. The procedural controls on senior committee membership and direction are all the more significant because of the explicit delegation of organizational authority and independence to these five committees. Some activities of these five most important committees in the AICPA are discussed subsequently in the section titled "Activities of the AICPA," beginning on page 101.

JOINT TRIAL BOARD AND OTHER PERMANENT COMMITTEES

The bylaws provide that certain committees shall be permanent. They include the Nominations Committee and Board of Examiners, both described previously, and two others. One is the Professional Ethics Division which is headed by the Professional Ethics Executive Committee, one of the five autonomous senior technical committees. This division investigates potential disciplinary matters involving members of the AICPA. It also presents cases alleging violation of the

bylaws or code of professional ethics before the Joint Trial Board and interprets and proposes amendments to the code of professional ethics. The fourth permanent committee, which deals with ethics enforcement, is the Joint Trial Board.

Joint Trial Board

Since 1 August, 1975, the AICPA has operated a joint ethics enforcement plan in conjunction with the State CPA societies. A description of the enforcement plan has been prepared by the AICPA in response to a request from this subcommittee. It may be found in Appendix E at page 898.

The purpose of the joint enforcement plan is to eliminate duplication between the AICPA and the State professional CPA societies in disciplining a member of both groups. Sanctions against an offending member can be applied jointly by both the AICPA and the State society.

The maximum penalty which the AICPA can impose through its professional ethics division and Joint Trial Board is expulsion of a member from the membership ranks of the AICPA. A suspension or expulsion from the AICPA does not affect the ability of a person to practice as a CPA since the AICPA, as a trade association, has no legal authority over its members. The right to practice as a CPA is presently regulated by State boards of accountancy. Only action by a State board under the authority of a State government can initiate the removal or suspension of a licensed person from practicing as a CPA.

A system of regional trial boards is maintained to jointly adjudicate charges against members. The national review board hears appeals from actions by the regional trial boards, and also has authority to hear complaints originally. The national review board consists of 36 members of the AICPA in practice who are elected by the council.

The AICPA bylaws state that a member can be suspended without hearing for conviction of a felony, willful failure to file an income tax return, or filing or aiding the preparation of a fraudulent tax return.

The Joint Trial Board, after a hearing, can expel a member from the AICPA for other offenses by a two-thirds vote of the board members present and voting. An AICPA member may be suspended for a period not to exceed two years by a majority vote of the board, or lesser sanctions may be imposed.

The bylaws provide that an AICPA member can be sanctioned by the Joint Trial Board if:

> He infringes on any of the AICPA bylaws or any provision of the code of professional ethics;
>
> He is declared by a court of competent jurisdiction to have committed any fraud;
>
> He is found by the Joint Trial Board to have been guilty of an act, or to have been convicted of a criminal offense which tends to discredit the accounting profession, provided that convictions involving crimes of moral turpitude shall automatically result in expulsion from the AICPA;
>
> He is declared by any competent court to be insane or otherwise incompetent;

His license to practice as a CPA is suspended, revoked, withdrawn or cancelled as a disciplinary measure by any governmental authority; or

He fails to cooperate with the professional ethics division in any disciplinary investigation involving him or his associates by not responding to interrogatories within 30 days.

It is worth noting that an AICPA member apparently cannot be sanctioned for substandard or improper auditing and accounting, unless one of the enumerated provisions is somehow violated.

The bylaws allow for reinstatement of a member in the AICPA through application to the Joint Trial Board. The board may rescind or modify its sanction by a two-thirds vote. Unsuccessful applicants for reinstatement may apply again after two years.

The bylaws also provide for publishing the identity and offenses of disciplined members in a periodical of the AICPA. Publishing the identity of offenders is not mandatory, however, and a majority of the Joint Trial Board must vote in favor of publication.

ADVISORY COMMITTEES

Five advisory committees were formed recently to advise the other AICPA committees. The AICPA Committee Handbook describes these committees in the following manner:

> Although the AICPA members have a common interest in the broad subjects of accounting, auditing, taxes and management, within the membership are various groups whose interests and needs are not wholly identical. The Chairman of the Board has therefore appointed committees representing the special interests of those groups to advise existing committees and boards with respect to issues of interest to their group. At the present time, there are three advisory committees representing practicing firms, one representing members in government and industry and one representing members in education. The committees provide input on behalf of their constituents to existing committees and boards; they do not themselves establish policy or standards.

The five advisory committees were formed during 1975 after a number of large accounting firms decided that a better method was needed to promote the interests of various groups in the AICPA. In response to a request from this subcommittee, the AICPA has provided a detailed list of the membership and recommendations of each advisory committee. (See Appendix E, page 905.)

Three advisory committees are comprised of practicing accountants, divided according to the number of members in each firm and the scope of a firm's practice. For example, the Group A Advisory Committee represents local accounting firms and practice units with less than 50 professional members. A "practice unit" is a group of one or more accountants organized to provide professional accounting services to clients on a fee basis. This committee has 15 members and represents over 17,000 local accounting firms and practice units throughout the United States.

The Group B Advisory Committee represents regional accounting firms ranging in size from approximately 50 to 200 professional members. There are 21 members on this advisory committee representing all of the 21 firms in this category.

The Group C Advisory Committee represents the large national accounting firms. There are 15 firms in this category—the "Big Eight" and the next seven largest accounting firms. Of the 11 seats on the Group C Advisory Committee, eight are permanently assigned to the "Big Eight" accounting firms. The remaining three seats are filled on a rotating basis from a pool comprised of the next seven largest firms.

The three practice advisory committees provide an organized forum for mutual consultation and planning among accounting firms in the same approximate size category. The difference between the group A committee representing local practitioners and the group B and C committees representing regional and national firms lies in the proportion of group members actually represented on the advisory committee. The 15 members on the group A committee are only a small fraction of the 17,000 accounting firms and practice units in that category, whereas the group B and C committee memberships directly represent almost every accounting firm in those categories.

The remaining two advisory committees are the Educators' Advisory Committee, with 15 committee members representing the interests of 3,401 academic accountants, and the Industry and Government Advisory Committee, consisting of 15 members to represent the interests of 44,575 accountants in business and government.

The advisory committee structure permits all of the "Big Eight" firms, as well as the rotating members of the next seven firms, to consult, plan, and coordinate their efforts toward influencing the AICPA's policies and activities. Similarly, the 21 regional firms are able to meet together on an organized basis to advance their mutual interests.

CHAPTER III. INFLUENCE OF THE "BIG EIGHT" ACCOUNTING FIRMS IN THE AICPA

Introduction

The organizational structure and procedures of the AICPA have been shown to foster continuing control over AICPA policies and activities by the individuals and groups which presently hold power and exercise influence in the organization. The next step in evaluating the directions taken by the AICPA is to identify the individuals and groups currently holding those positions in the AICPA.

That task is not difficult because the positions of power and influence in the AICPA are held for the most part by representatives of the "Big Eight" and, to some extent, the next seven largest accounting firms. The influence wielded by these large national accounting firms far exceeds their proportionate representation in the total membership of the AICPA. The extent of their influence is related to the vast amount of wealth and prestige concentrated in such a small number of very large firms.

A look at the basic size of the AICPA membership and its classifications helps to put into perspective the influence of the "Big Eight" firms. The AICPA has released figures as of 31 January, 1976, showing the classification of its membership by occupation and size of practice unit. For comparison, the percentage figures from 31 July, 1975 and 1974 are also shown.

TOTAL AICPA MEMBERSHIP BY CLASSIFICATIONS

	Number 1976	Percent 1976	Percent July 1975	Percent July 1974
Occupational classification of members:				
Public accounting	69,719	59.2	59.1	60.0
Business, industry, miscellaneous	40,578	34.5	34.6	33.6
Education	3,401	2.9	2.9	3.0
Government	3,997	3.4	3.4	3.4
Total	117,695	100.0	100.0	100.0
Sources of practicing membership (firm size):				
Firms with 1 member	15,019	21.5	22.1	21.5
Firms with 2 to 9 members	20,605	29.6	29.7	30.5
Firms with 10 or more, except 25 largest firms	7,441	10.7	10.1	9.3
25 largest firms	26,654	38.2	38.1	38.7
Total	69,719	100.0	100.0	100.0

The questionnaire sent to the "Big Eight" firms by this subcommittee requested the number of persons in each firm who were members of the AICPA. Seven of the firms provided that information, and Peat, Marwick, Mitchell & Co. responded that it did not know. The AICPA membership of the seven firms answering the question totals 14,395. Based on the ratio of AICPA members to the total number of partners and staff in the other seven firms, the subcommittee estimates

that Peat, Marwick, Mitchell & Co. has approximately 3,000 partners and employees who are AICPA members. That indicates that the total number of AICPA members from "Big Eight" firms is about 17,400.

Membership figures released by the AICPA show that it has a total membership of 117,695. Thus, approximately 15 percent of the total AICPA membership is from the "Big Eight" firms. However, as the following analysis demonstrates, their representation in the significant areas of AICPA policy-making and activities is much greater than 15 percent.

Two factors should be noted when evaluating the representation of the "Big Eight" firms on the governing bodies and committees of the AICPA. First, an accounting firm is generally represented only once in the total membership of any AICPA committee or board.

The numerical size of a committee or board affects the proportionate share of "Big Eight" representation. For example, all the "Big Eight" firms are represented on the Editorial Advisory Committee for "The Tax Advisor" which has 19 members, a proportionate representation of 42 percent. However, all of the "Big Eight" firms are also represented on the Cost Accounting Standards Board Committee which has only nine members, a proportionate representation of 89 percent.

Secondly, the position held by a "Big Eight" representative may be more important than the proportionate share of their members on a governing body or committee. In many cases where the proportionate membership of "Big Eight" firms is lower than usual, a "Big Eight" representative is committee chairman.

The fiscal 1976 AICPA council consisted of 252 members given the power to exercise the ultimate authority of the AICPA as provided in the bylaws. The number of council members from "Big Eight" firms was 78, or 31 percent of the total council membership. When the number of council members from the next seven largest firms is added to the "Big Eight" membership, the number rises to 107, representing 42 percent of the total council.

Although the proportionate representation of "Big Eight" firms on the council was more than double the proportion of their members to the total AICPA membership, their representation was even greater on certain of the six basic membership groups comprising the council. The following table illustrates the number and proportion of "Big Eight" members in each of the six membership groups described on page 71.

"BIG EIGHT" REPRESENTATION ON THE FISCAL 1976 AICPA COUNCIL

	Total	"Big Eight" Representatives	"Big Eight' Percentage
Officers of AICPA	7	3	43
Elected members:			
For 3 yr	37	15	41
For 2 yr	42	15	36
For 1 yr	58	8	14
Members at large:			
For 3 yr	7	2	29
For 2 yr	7	2	29
For 1 yr	7	2	29
Ex officio members of the board of directors	9	3	33
Past presidents/chairmen of the board	24	13	54
Designated council representatives of State societies	54	15	28
Total representation	252	78	31

Several points should be noted concerning the "Big Eight" representation on the fiscal 1976 council:

(1) The vice chairman was the managing partner of Haskins & Sells, meaning that the next chairman of the board would be from a "Big Eight" firm because of the automatic succession procedure in the bylaws. As described in the Organization of the AICPA chapter, the chairman of the board is one of the most influential persons in the AICPA because he appoints the committees which perform specific tasks.

(2) While the total number of elected members is decreasing, the number of "Big Eight" representatives almost doubled from eight to 15 in the more recently elected groups. Thus, the percentage of "Big Eight" members elected each year jumped from 14 percent to 41 percent.

(3) Two of the seven members at large elected each year consistently represent "Big Eight" firms.

(4) The majority of "Big Eight" members in the past presidents/chairmen of the board category indicates that their influence in the highest AICPA office has been continuing for many years.

(5) Finally, the relatively low proportion of "Big Eight" representatives among the designated council representatives of State societies may reflect the fact that it is the only membership group on the council whose selection is not influenced by the Nominations Committee.

Nominations Committee

The Nominations Committee serves a vital role in the selection of over 78 percent of the AICPA council members. Three of the seven members on the Nominations Committee, including the committee chairman, represent "Big Eight" firms. In addition to being a "Big Eight" representative, the Nominations Committee chairman also served on the board of directors and was immediate past chairman of the board

As described previously, the Nominations Committee nominates the chairman and the vice chairman of the board, who in turn recommend to the council the members of the Nomination Committee. In view of this circular selection procedure, the choice of the immediate past chairman of the board to head the Nominations Committee certainly promotes the stated objective of the committee to "provide for continuity of leadership . . ."

Board of Directors

Six of the 18 members on the board of directors, including the immediate past chairman of the board and the designated next chairman of the board, represented "Big Eight" firms. If the board members who represented three of the next seven largest firms are added to the six "Big Eight" members, it is evident that half of the AICPA board of directors was from the 15 big national accounting firms.

Committees

The real work of the AICPA in terms of performing certain tasks and accomplishing specific goals is handled almost exclusively by the

AICPA committee structure. The 108 committees, subcommittees, and boards listed and described in the 1975–76 AICPA Committee Handbook cover every topic of interest to the accounting profession. They range from committees with limited impact, such as the Accounting Literature Awards Committee, to committees which are vitally important to the practice of accounting, such as the Auditing Standards Executive Committee.

While the influence of the "Big Eight" firms pervades the AICPA committee structure, their representation was concentrated on committees performing work in substantive areas that have an extensive impact on the actual practice of accounting, and frequently affect governmental policies. On several of the most important committees, the proportion of "Big Eight" representation exceeded 50 percent.

For example, there were no "Big Eight" representatives on the Accounting Literature Awards Committee, which selects for recognition articles, monographs, or books that make outstanding contributions to the literature of accounting. On the Accountant's Legal Liability Committee, however, all of the "Big Eight" firms were represented on the 16-person committee. That was half the membership of the committee dealing with the extent to which accountants should be legally liable for their actions.

The "Big Eight" representation on AICPA committees is divided into three basic categories for the purposes of this analysis. They are the senior technical committees, the committees involved with the Federal Government, and the other major AICPA committees. For each category, there is an accompanying table which graphically illustrates the degree of "Big Eight" influence on the committees within that category. A list of all AICPA committees showing the representation of "Big Eight" firms is contained in Appendix E, page 1078.

SENIOR TECHNICAL COMMITTEES

The five senior technical committees are the most important committees of the AICPA. Their areas of activity encompass the issues and decisions which are the most fundamental to the practice of all accountants, and especially to the large national accounting firms and their corporate clients. Because the accounting profession is largely self-regulated, and the Federal agencies and State boards of accountancy charged with regulating accountants have chosen to rely upon the AICPA to such a great extent, the pronouncements of the senior technical committees have become the prescribed standard regarding the five most substantive areas of accounting.

Practicing accountants must follow the edicts of the senior technical committees, or risk disciplinary action by governmental authorities, as well as the AICPA itself. Despite their tremendous authority, the senior technical committees are not responsible to the public. Their procedures do not protect either the public or accountants who may differ with the committee members. However, the public is ultimately affected by these committees because the quality of the financial information received from the practice of accounting is directly related to the decisions of the senior technical committees.

The source of power for the AICPA's senior technical committees derives from the decisions of certain Federal and State governmental authorities to recognize the rules established by these committees. In

other words, the standards promulgated by these committees have become the standards enforced by government authorities which all CPAs must follow.

Although there has been some recent progress in the setting of financial accounting standards, the government authorities choosing to rely upon the AICPA's senior technical committees have not insisted upon procedural guarantees to protect the public interest. Government authorities have not required balanced committee membership, open meetings, advance notice, or any of the other procedural guarantees generally associated with government efforts to promote the public interest.

Federal agencies and State boards of accountancy have been willing to depend on the AICPA's senior technical committees without ensuring that the committees act in the public interest. As a result, these committees operate according to the wishes of their own members. The "Big Eight" accounting firms have a dominant position of influence on all the senior technical committees.

As previously described, the AICPA bylaws specifically permit the senior technical committees to speak for the AICPA in their respective subject areas without clearance of either the board of directors or the council—the bodies endowed with its basic policy-making authority. In turn, Federal and State governmental authorities have accepted the committee decisions as official pronouncements of the AICPA.

The only procedural safeguard on the powerful senior technical committees is the AICPA bylaw requirement that appointments to these committees by the chairman of the board be approved by the board of directors. In effect, the requirement of board approval only enhances the tendency of the appointees to reflect the prevailing views of the AICPA's power structure. Although theoretically independent of the board of directors, the manner of selection makes it highly unlikely that members of the senior technical committees will act against the wishes of the AICPA power structure. The interlocking representation of the "Big Eight" firms in both the power structure and the committee structure provides further assurance that each will complement the other.

Being the designated independent authority to speak for the AICPA in the most crucial areas of accounting may not actually insulate the senior technical committees from the AICPA power structure. However, the special status of these committees effectively insulates their operations from the members of the AICPA who do not control the power structure. In that respect, the senior technical committees are not directly responsible to either the membership of the AICPA or the public. Yet, both the public and the accounting profession are profoundly influenced by the activities of the senior technical committees.

The functions of each senior technical committee and its "Big Eight" representation are as follows:

Accounting Standards Executive Committee

The Accounting Standards Executive Committee is the official spokesman for the AICPA on matters pertaining to financial accounting standards. Its responsibilities include developing the AICPA position on financial accounting and reporting standards and maintaining liaison with the Financial Accounting Standards Board and the Cost Accounting Standards Board.

The issues regarding financial accounting and reporting involve the quality and quantity of information shown in financial statements. Such issues include the value of assets, depreciation policies, inventory amounts, revenue and expense recognition, supporting factual data, and many other determinations which control the profits shown by a business unit and the information given to the public on business operations. The very essence of the need for financial accounting and reporting in society, its purpose, and its viability are the issues addressed by the Accounting Standards Executive Committee on behalf of the AICPA.

The determination of financial accounting and reporting standards has been a controversial issue for many years. Severe problems have occurred concerning the presentation and interpretation of information contained in financial statements because uniform accounting standards have never been developed or enforced.

The AICPA committee structure is instrumental in determining financial accounting and reporting standards through its role in issuing statements of position on unresolved accounting matters, and its role as advocate of the AICPA position before the FASB and other organizations. Complete responsibility for performing these tasks on behalf of the AICPA has been assigned to the Accounting Standards Executive Committee.

In fiscal 1976, the Accounting Standards Executive Committee had 15 members. Eight of them, including the chairman, represented the "Big Eight" accounting firms, a 53 percent share of the AICPA's official voice in one of the most important and basic areas of accounting. Four committee members came from the next seven largest accounting firms, giving the 15 largest firms 80 percent of the committee membership. Clearly, the Accounting Standards Executive Committee was dominated by these firms.

TABLE II.—"BIG EIGHT" ACCOUNTING FIRM MEMBERSHIP ON AICPA SENIOR TECHNICAL COMMITTEES

	Arthur Andersen	Arthur Young	Coopers & Lybrand	Ernst & Ernst	Haskins & Sells	Peat, Marwick & Mitchell	Price Waterhouse	Touche Ross	Percentage of total committee membership
Accounting Standards Executive Committee.	X	X	X	X	X	X	X*	X	53
Auditing Standards Executive Committee.	X	X	X*	X	X	X	X	X	38
Federal Taxation Executive Committee	X*	X	--------	X	X	X	X	X	47
Management Advisory Services Executive Committee.	X	X	X	X	X	X*	X	X	53
Professional Ethics Executive Committee.	X	--------	X	X	X	--------	--------	X	50

* Chairman.

Auditing Standards Executive Committee

Along with the setting of financial accounting and reporting standards, the determination of auditing standards is the most important area of concern to accountants. Accounting standards are used to determine proper presentation of financial information so that it conveys a true picture of the financial status of a business unit, whereas auditing standards are used to guide the accountant

in determining the accuracy and consistency of financial and operational data which support the financial statements.

Meaningful auditing standards are important to businesses for controlling internal costs and operations, but they are most important to accountants because of the "attest function." When accountants express an opinion on, or "certify," financial statements, they attest that the information presented is reliable because it is supported by sound, accurate data. Accountants are actually selling their reputations as independent, knowledgeable professionals when certifying financial statements for use by third parties.

The determination of auditing standards, therefore, defines the responsibilities of accountants in assuring the accuracy of financial and operational data which support financial statements.

Legal liability of accountants in cases of alleged negligence and fraud focuses upon the application of sound auditing techniques which would permit an accountant to state with assurance that certified financial statements are a fair presentation of business activities. Auditing standards are used in defining the legal liability of accountants to third parties for false information associated with certified financial statements.

The AICPA performs a key function by setting auditing standards in a manner similar to its previous promulgation of accounting standards. It develops and publishes generally accepted auditing standards (GAAS) as Statements on Auditing Standards (SAS).

The role of the AICPA in determining auditing standards has not been seriously challenged. The Federal Government, State governments, and courts of law have tended to accept its definition of proper auditing. A continuing series of unexpected major business failures combined with revelations of illegal secret funds in large corporations has raised serious questions about the adequacy of current auditing procedures. (See p. 188.)

The Auditing Standards Executive Committee has been given the authority to act and speak on behalf of the AICPA regarding auditing matters. It exercises the AICPA's power and prestige in setting the standards which determine the responsibilities and legal liability of accountants. This committee is in the unique position of deciding what others may expect from accountants, and releasing their decisions as statements on auditing standards.

Its pronouncements are binding on accountants because Federal and State agencies have decided to recognize them. The accounting profession, and ultimately the public, depend on auditing standards to establish the reliability of financial statements, but the Auditing Standards Executive Committee operates autonomously on behalf of the AICPA. There are no provisions to guarantee public participation in the decision-making process.

Table II on page 90 shows that all the "Big Eight" accounting firms are on the 21-member Auditing Standards Executive Committee. Thus, 38 percent of the committee, including the chairman, represents these firms. There are also six committee members from the next seven largest accounting firms. The combined representation of the 15 largest accounting firms is thus 14, or two-thirds of the total committee membership.

Federal Taxation Executive Committee

Unlike the other four senior technical committees, the Federal Taxation Executive Committee is not involved in setting standards which affect the practice of all accountants. Instead, this committee is the designated voice of the AICPA regarding all aspects of Federal taxation. Its purpose is to influence Congress, the Treasury Department, and the Internal Revenue Service on matters of tax policy and technical application of the tax laws.

In essence, the Federal Taxation Executive Committee is the lobbying arm of the AICPA on Federal tax matters. Although this committee is not involved with setting standards which define the professional practice of accountants, it does enunciate the view of the accounting profession on the content and application of Federal tax laws. Providing advice to clients on Federal taxes is a substantial part of the services offered by most accountants, so the committee handling Federal tax matters on behalf of the AICPA is important enough to be designated as a senior technical committee by the AICPA power structure.

The Federal tax laws are important to all accountants because a significant portion of revenues received from their clients is related to the performance of tax services. There is a distinction, however, between the accountant's valid concern over proper application of existing tax laws and attempts by the AICPA to influence tax policy and legislation on behalf of clients. When accountants assume a partisan stance in favor of their clients' political objectives, they compromise their position of independence upon which their professional reputation is based.

There are 15 members on the Federal Taxation Executive Committee who are responsible for its activities as well as the activities of its 13 subcommittees. The "Big Eight" firms hold seven seats, including the chairmanship, for a proportional representation of 47 percent. Four seats are held by representatives from the next seven largest accounting firms, for a total of 11 committee members from the 15 largest accounting firms. That amounts to 73 percent of the total committee membership.

Data received from the "Big Eight" accounting firms in response to this subcommittee's questionnaire shows that the performance of tax services averaged 18 percent of their total revenues. Individual practitioners and small accounting firms often receive an even greater percentage of their revenues from tax services performed for clients, but they are not significantly represented on this committee.

Management Advisory Services Executive Committee

Table II on page 90 shows that all of the "Big Eight" firms are on the Management Advisory Services Executive Committee, and that, once again, the committee chairman is from a "Big Eight" firm. This committee is important because it is assigned to act for the AICPA in developing standards and guidelines for the ethical and competent performance of management advisory services by accountants. Governmental authorities rely upon the AICPA to determine proper standards in this area, and the committee performs the task in the name of the AICPA.

Management advisory services cover a wide range of subject areas where businesses hire outside contractors to provide advice or actually

perform work for them. Some of the better known management advisory services rendered by accounting firms are executive recruitment, marketing analysis, plant layout, product analysis, actuarial planning and computations, and financial management services. Several large accounting firms—including the "Big Eight"—have actively promoted their capability to provide management advisory services, and have acquired experts who are not CPAs to perform services in those areas.

As with tax services, a distinction must be made between the proper role of accountants in providing management advisory services, and the loss of professional independence which results from permitting those services to interfere with the accountant's basic accounting and auditing responsibilities. Serious problems arise when accountants actively expand into areas not truly related to auditing and accounting, or when a client is publicly-owned and third parties expect an accountant to be truly independent of the client's management.

Like the Federal Taxation Executive Committee, the Management Advisory Services Executive Committee has not effectively limited the role of CPAs in providing non-accounting services. Instead, it has encouraged accountants to provide management advisory services on a broad scale.

The "Big Eight" firms have a 53 percent representation on the 15-member Management Advisory Services Executive Committee, including the chairman. There are also three representatives from the next seven largest accounting firms, for a total of 11 committee members from the 15 largest accounting firms. That is a proportional representation of 73 percent.

Professional Ethics Executive Committee

The Professional Ethics Executive Committee is the last of the five senior technical committees which act independently on behalf of the AICPA. Since the accounting profession is largely self-regulated, governmental authorities tend to rely upon the profession to determine its own ethical standards.

The AICPA has assumed the role of setting ethical standards for the accounting profession, and the Professional Ethics Executive Committee has been assigned that task. Ethical standards determine what services an accountant may properly offer and the manner in which such services are offered.

For example, advertising by accountants, independence of accountants, and relationships with clients are all areas covered by the professional code of ethics. By defining the manner in which accountants may practice, the code of ethics greatly affects the reputation as well as the earnings of accountants.

The Professional Ethics Executive Committee is also responsible for establishing and presenting apparent violations of ethical standards before the AICPA's Joint Trial Board. The committee is therefore in a position to decide who shall be charged and whether lesser administrative action should be applied to ethics code violators.

The Professional Ethics Executive Committee has ten members, five of whom are from "Big Eight" firms. The 50 percent representation of the "Big Eight" is increased to 60 percent from the 15 largest firms when the committee member from one of the next seven largest firms is included.

There are three subcommittees associated with the Professional Ethics Executive Committee, and the "Big Eight" have a commanding position on all of them.

In summary, it is evident that the five senior technical committees are authorized to act independently for the AICPA in their respective subject areas, which are the five most important areas affecting the practice of accounting. Table II on page 90 shows that the "Big Eight" firms dominate all five committees, and that four of the committee chairmen are from "Big Eight" firms. Together with the next seven largest accounting firms, they have an overwhelming majority on each committee. The actions taken by these committees are thus controlled by the 15 largest accounting firms in the United States.

AICPA Committees Involved With the Federal Government

Many committees of the AICPA deal with the Federal Government in one way or another, but several AICPA committees were specifically established to handle matters with certain arms of the Federal Government. These committees are of special interest to Congress because they determine the positions taken by the AICPA on issues before the Federal Government. Table III below shows the heavy concentration of "Big Eight" firm representation on these committees.

TABLE III.—"BIG EIGHT" ACCOUNTING FIRM MEMBERSHIP ON AICPA COMMITTEES INVOLVED WITH THE FEDERAL GOVERNMENT

	Arthur Andersen	Arthur Young	Coopers & Lybrand	Ernst & Ernst	Haskins & Sells	Peat, Marwick & Mitchell	Price Waterhouse	Touche Ross	Percentage of total committee membership
Cost Accounting Standards Board Committee	X	X*	X	X	X	X	X	X	89
Federal Government Executive Committee	X	X	X*	X	X	X	X	X	73
Federally Assisted Programs Subcommittee	X*	X	X	X	X	X	X	--------	50
Financial Institutions Subcommittee	X	X	X	X*	X	X	X	X	67
Relations With GAO Subcommittee	X	--------	X	X	X	X	X	X*	70
Regulated Industries Subcommittee	X	X	X	X	X*	X	X	X	73
Federal Taxation Executive Committee	X*	X	--------	X	X	X	X	X	47
Employee Benefits Subcommittee	X	X	--------	X	--------	X*	X	--------	56
International Taxation Subcommittee	X	X*	X	X	X	--------	--------	X	60
Tax Accounting Subcommittee	X	--------	--------	X	X	--------	X	X	56
Tax Policy Subcommittee	--------	X	X	X	--------	X	--------	--------	44
Taxation of Corporate Distributions and Adjustments Subcommittee	X	X	--------	X	--------	--------	X*	--------	44
SEC Regulations Committee	X	X	X	X	X	X*	X	X	44

* Chairman.

Except for the Federal Taxation Executive Committee, none of these committees are senior technical committees. That means the chairman of the board can appoint the members and assign responsibilities of these committees completely on his own. Unlike the senior technical committees, however, ordinary committees are not designated as independent spokesmen for the AICPA. All ordinary committees are responsible to the AICPA's board of directors.

COST ACCOUNTING STANDARDS BOARD COMMITTEE

The Cost Accounting Standards Board Committee's stated objective is "to consult with, advise and assist the Cost Accounting Standards

Board in its efforts to develop uniform cost accounting standards." There are nine members on this committee. The chairman and seven of the members are from the "Big Eight" accounting firms. The ninth member represents one of the next seven largest firms, so the Cost Accounting Standards Board Committee is composed 100 percent from members of the 15 largest accounting firms.

FEDERAL GOVERNMENT EXECUTIVE COMMITTEE

The objective of the Federal Government Executive Committee is "to assist in the development of a more effective relationship with leaders in the government and executive branch. To identify public issues on which the public accounting profession is particularly qualified to make a contribution. To provide advice on how the accounting profession can make its skills available to the government in its effort to improve its financial controls."

This committee was formed to influence Federal Government officials and activities on behalf of the accounting profession, as represented by the AICPA. That task is to be accomplished through direct interaction with the Federal Government, as well as providing advice to the senior technical committees and other committees of the AICPA.

Four subcommittees work under the Federal Government Executive Committee to help achieve its goals. Each has responsibilities in important areas of Federal Government activity.

The Federally Assisted Programs Subcommittee is "to provide advice and assistance to federal agencies responsible for the administration of federal assistance programs with the development of effective audit programs which are consistent with broad federal policies. To advise senior technical committees and AICPA members regarding relevant matters."

The Financial Institutions Subcommittee is "to provide advice and assistance to federal regulatory agencies for banks, savings and loans, and other institutions in consideration of accounting and auditing problems. To promote better understanding among credit executives as to the services of accountants and the significance of their reports."

The objective of the Relations With GAO (General Accounting Office) Subcommittee is "to provide advice and assistance to the GAO in matters of mutual concern in the public interest. To advise senior technical committees and AICPA members regarding relevant matters."

The Regulated Industries Subcommittee is "to provide advice and assistance to regulatory agencies in consideration of accounting and auditing problems. To encourage conformity between generally accepted accounting principles and regulatory accounting requirements. To advise senior technical committees of current and anticipated accounting problems."

There is presently no conformity among generally accepted accounting principles (GAAP). The goal of the Regulated Industries Subcommittee is apparently to encourage Federal agencies to adhere to the same confusing standards which plague the financial statements of non-regulated industries. The problems associated with GAAP are considered elsewhere in this study, but this is another example of the AICPA's attempts to influence the accounting practices of the Fed-

eral Government in a way which is not consistent with proper Federal accounting objectives.

Table III on page 94 shows clearly that the Federal Government Executive Committee and its subcommittees are dominated by representatives from the "Big Eight" accounting firms. Not only do they have controlling representation on these committees, but all five committee chairmen are from "Big Eight" firms. The interest of these firms in influencing the Federal Government through the AICPA is evidenced by the fact that all eight firms are represented on the Federal Government Executive Committee and two of its subcommittees. Seven of the eight firms are on the other two subcommittees.

If the committee members from the next seven largest firms are added to the "Big Eight" membership, the total proportionate representation from the 15 largest accounting firms becomes 82 percent for the Federal Government Executive Committee, 71 percent for the Federally Assisted Programs Subcommittee, 75 percent for the Financial Institutions Subcommittee, and 82 percent for the Regulated Industries Subcommittee.

The membership lists for these AICPA committees also disclose that Federal employees serve on two subcommittees. The Federally Assisted Programs Subcommittee has one member from the General Services Administration and another member from the Department of Health, Education and Welfare. The Regulated Industries Subcommittee has one member from the Rural Electrification Administration in the Department of Agriculture.

As the AICPA is a registered lobbyist, the propriety of Federal employees serving on AICPA committees which are specifically assigned to influence Federal policies and personnel is highly questionable. This is especially true since the views expressed by the AICPA reflect the interests of the large national accounting firms. Those views are often controversial and detrimental to proper Federal accounting practices. Federal employees affect Federal accounting practices through the performance of their official duties, and there is no need for them to participate in influencing other Federal employees through a professional lobbying organization.

FEDERAL TAXATION EXECUTIVE COMMITTEE

As previously described on page 80, the Federal Taxation Executive Committee is assigned the task of developing AICPA positions on Federal tax policies, and promoting those positions before Congress and Federal departments. The committee is controlled by the 15 largest national accounting firms.

The Federal Taxation Executive Committee directs 13 subcommittees whose stated objectives are described in Appendix E, page 943. "Big Eight" influence is significant on most of them, but five subcommittees are clearly dominated by the "Big Eight" accounting firms. Table III illustrates the representation of the "Big Eight" on those five subcommittees.

The dominant position of the "Big Eight" firms on the Federal taxation subcommittees is enhanced even further if representatives from the next seven largest accounting firms are included. The total proportional representation of the 15 largest accounting firms on each of the five named subcommittees is: 67 percent on the Employee Benefits Subcommittee; 80 percent on the International Taxation Subcom-

mittee; 78 percent on the Tax Accounting Subcommittee; 78 percent on the Tax Policy Subcommittee; and 67 percent on the Taxation of Corporate Distributions and Adjustments Subcommittee.

SEC REGULATIONS COMMITTEE

The objective of the AICPA's SEC Regulations Committee is "to provide advice and assistance to the SEC as to its procedures on accounting for and auditing of registrants. To advise senior technical committees and AICPA members regarding relevant matters."

This committee operates in the same manner as the Cost Accounting Standards Board Committee and the Federal Government Executive Committee. Its purpose is to influence the actions of the SEC so that they are favorable to the interests of the AICPA.

The SEC is the most important Federal agency affecting AICPA members with publicly-owned corporations as clients. The SEC determines reporting requirements of publicly-owned corporations under the Federal securities laws, and has the authority from Congress to set accounting standards. Actions taken by the SEC may override standards set by the accounting profession for its own benefit and that of its clients.

The SEC Regulations Committee has 18 members, eight of whom are from the "Big Eight" firms. The committee chairman is a "Big Eight" representative. The 44 percent representation of these firms increases to 78 percent when the six committee members from the next seven largest accounting firms are included.

In summary, all the AICPA committees formed to deal with the Federal Government are controlled by the "Big Eight" accounting firms. When the AICPA speaks to the Federal Government, it is the voice of the "Big Eight" and, to some extent, the next seven largest accounting firms.

Some other aspects of the AICPA's organized effort to influence the Federal Government should be noted. The first is that advice and assistance provided to the Federal Government, to the extent it is accepted, affects the accounting practices of AICPA members and their clients. When CPAs become advocates on controversial and political issues—such as fair taxation, the proper amount of public reporting, and preferred valuation standards—their claim of independence is seriously eroded. The accountant's assertion of independence is the one quality which sets accountants apart from other professions and segments of society.

Secondly, advice provided to the Federal Government by the AICPA and the accounting profession is not free. Certainly, there is a cost to the public associated with following accounting practices preferred by the AICPA committee structure, rather than using accounting practices suggested by other parties with less of a vested financial interest in the outcome. Moreover, the "Big Eight" firms offer consulting services to the Federal Government on a fee basis, which is yet another source of revenue for them.

OTHER MAJOR AICPA COMMITTEES

Several other important AICPA committees are dominated by the "Big Eight" accounting firms. Representation by the next seven larg-

est accounting firms is also substantial on these committees. Table IV shows the "Big Eight" participation on each committee.

TABLE IV.—"BIG EIGHT" ACCOUNTING FIRM MEMBERSHIP ON OTHER MAJOR AICPA COMMITTEES

	Arthur Andersen	Arthur Young	Coopers & Lybrand	Ernst & Ernst	Haskins & Sells	Peat, Marwick & Mitchell	Price Waterhouse	Touche Ross	Percentage of total committee membership
Accountants Legal Liability Committee	×	×	×	×	×	×	×	×	50
Relations With Actuaries Committee		×	×	×	×	×	×*	×	78
State and Local Government Auditing Subcommittee		×*	×	×		×	×	×	40
Statistical Sampling Subcommittee	×	×	×	×	×	×	×	×*	53
Stockbrokerage Auditing Subcommittee	×	×	×	×	×	×*	×	×	67
Board of Directors of the AICPA		×	×	×	×		×	×	33
Planning and Finance Committee			×	×			×	×*	57
Computer Services Executive Committee	×*	×				×	×	×	50
Editorial Advisory Committee: "Journal of Accountancy"	×		×		×	×(2)	×(2)	×	19
Editorial Advisory Committee: "The Tax Advisor"	×	×	×	×	×	×	×	×	42
Information Retrieval Committee	×	×	×	×*	×	×	×	×	62
International Practice Executive Committee	×	×	×	×	×	×	×	×	44
Practice Review Committee			×	×	×	×			40

* Chairman.

The objectives of these committees as stated in the AICPA Committee Handbook is included in Appendix E at page 946. A complete list of all committee objectives and memberships is also contained in the committee handbook, which may be obtained from the AICPA.

The composition of the Planning and Finance Committee illustrates how the "Big Eight" accounting firms maintain control over the AICPA organization and staff through dominant representation on key committees.

Four of the seven members on this committee represent "Big Eight" firms, a 57 percent representation. The Planning and Finance Committee determines the compensation of AICPA staff officers. Two of the seven members are full-time salaried staff officers of the AICPA. Four of the five other members come from "Big Eight" firms. Thus they provide 80 percent of the non-staff membership on the committee which determines the salaries and benefits of the officers who administer AICPA programs and direct the AICPA staff.

To supplement the information on "Big Eight" committee membership shown in Table IV, the following list shows the proportionate representation of the largest 15 accounting firms on the other major AICPA committees:

Accountants' Legal Liability Committee: 12 of 16 members from the largest 15 firms; 75 percent of the total committee membership.

Relations with Actuaries Committee: 8 of 9 members from the largest 15 firms; 89 percent of the total committee membership.

State and Local Government Auditing Subcommittee: 6 of 15 members from the largest 15 firms; 40 percent of the total committee membership.

Statistical Sampling Subcommittee: 12 of 15 members from the largest 15 firms: 80 percent of the total committee membership.

Stockbrokerage Auditing Subcommittee: 10 of 12 members from the 15 largest firms: 83 percent of the total committee membership.

Board of Directors of the AICPA: 9 of 18 members from the 15 largest firms; 50 percent of the total committee membership.

Planning and Finance Committee: 4 of 7 members from the 15 largest firms; 57 percent of the total committee membership.

Computer Services Executive Committee: 6 of 10 members from the 15 largest firms: 60 percent of the total committee membership.

Editorial Advisory Committee—"Journal of Accountancy": 12 of 43 members from the 15 largest firms; 28 percent of the total committee membership.

Editorial Advisory Committee—"The Tax Advisor": 13 of 19 members from the 15 largest firms: 68 percent of the total committee membership.

Information Retrieval Committee: 11 of 13 members from the 15 largest firms; 85 percent of the total committee membership.

International Practice Executive Committee: 15 of 18 members from the 15 largest firms; 83 percent of the total committee membership.

Practice Review Committee: 6 of 10 members from the 15 largest firms; 60 percent of the total committee membership.

Advisory Committees

As described previously on page 83, the 15 largest accounting firms have their own exclusive advisory committee within the AICPA. This committee is one of five formed to promote the special interests of various groups before the other AICPA committees.

A list of the recommendations made so far by each of the five advisory committees is contained in Exhibit 5 of the AICPA's response to questions from this subcommittee. (See Appendix E, page 905.)

The complete domination of the important AICPA committees by the 15 largest national accounting firms is perhaps best illustrated by recommendations of the four advisory committees representing AICPA members from the regional accounting firms, local accounting firms, academics, and business and government. Each of those advisory committees has recommended that its segment of AICPA membership be given greater participation in the AICPA committee structure.

Summary

The "Big Eight" accounting firms effectively control the operating structure of the AICPA. They have managed to achieve control through representation in policy-making positions and on committees which far exceeds their proportional representation among the AICPA's membership.

The next seven largest accounting firms have interests which are very similar to those of the "Big Eight" firms. When their representation is combined with that of the "Big Eight," the result is outright

domination of every meaningful aspect of AICPA organization and activity.

About 15 percent of the AICPA's total membership is from the "Big Eight" firms, yet they held 31 percent of the seats on the AICPA council and 33 percent of the positions on the board of directors in fiscal 1976. The combined representation of the 15 largest accounting firms amounted to 42 percent of the council and 50 percent of the board of directors. The direct representation of the 15 largest firms is augmented by their influence in the selection of other council and board members who are amenable to their interests.

Although the "Big Eight" dominate the power structure of the AICPA, they have even greater strength on the significant AICPA committees. Almost every chairman of a significant committee is from a "Big Eight" firm. The direct "Big Eight" representation on the important AICPA committees generally amounts to 50 percent or more. When representatives from the next seven largest accounting firms are included, the representation from the 15 largest firms usually reaches at least a two-thirds majority of a committee's membership.

The control over AICPA committee activities exercised through direct representation of the largest accounting firms is supplemented by their influence in selecting like-minded AICPA members for the remaining committee positions. The influence of the "Big Eight" firms is pervasive throughout the AICPA organization, but it is especially concentrated on committees concerned with any matters of significance to the accounting profession.

As a rule, an important committee can be recognized by its heavy concentration of "Big Eight" members. Nearly all specific AICPA activities are handled by committees, and the five senior technical committees are even designated independently as the official spokesmen for the AICPA within their areas of interest.

The representation of each "Big Eight" firm on the AICPA's 108 committees, subcommittees and boards in fiscal 1976 can be summarized as follows:

Arthur Andersen & Co. had 34 persons serving on 43 committees, and 5 of them were committee chairmen.

Arthur Young & Co. had 38 persons serving on 46 committees, and 10 of them were committee chairmen.

Coopers & Lybrand had 37 persons serving on 43 committees, and 5 of them were committee chairmen.

Ernst & Ernst had 37 persons serving on 47 committees, and 6 of them were committee chairmen.

Haskins & Sells had 35 persons serving on 44 committees, and 4 of them were committee chairmen.

Peat, Marwick, Mitchell & Co. had 36 persons serving on 38 committees, and 7 of them were committee chairmen.

Price Waterhouse & Co. had 34 persons serving on 41 committees, and 5 of them were committee chairmen.

Touche Ross & Co. had 40 persons serving on 49 committees, and 7 of them were committee chairmen.

One point of interest is that "Big Eight" firm membership on AICPA committees was fairly evenly divided among the eight firms. The single most important observation, however, is that the AICPA speaks with the voice of the "Big Eight" and, to some extent, the next seven largest accounting firms, when it speaks through its power structure or its significant committees.

CHAPTER IV. ACTIVITIES OF THE AICPA

Introduction

The previous two sections have considered the organization of the AICPA and the influence of the "Big Eight" and next seven largest accounting firms within the AICPA. It has been shown that the AICPA is organized in a manner which permits the persons and groups who presently control its operating structure to effectively perpetuate their control of the organization. It has also been shown that the "Big Eight" and, to some extent, the next seven largest accounting firms have effective control of the AICPA operating structure, and are thus in a position to direct its activities and continue their control.

The next step is to examine the activities of the AICPA in order to evaluate the effects of the "Big Eight" firms' control over the organization which is supposed to represent a diverse membership of over 117,000 CPAs. The activities of the AICPA are too extensive to be described fully in this study, but certain functions and projects highlight the nature of its activities. A more complete description of the scope of its activities is contained in the AICPA annual report and the response of the AICPA to requests by this subcommittee. (See Appendix E, page 873.)

The AICPA bylaws list its objectives and describe the professional practice of CPAs. Both of these may be found in Appendix E at page 996. These bylaw statements are useful in understanding the broad array of activities envisioned as the proper domain of the AICPA and its members.

Certain of the statements concerning the proper activities of CPAs are related to the type of clients being served by an accounting firm. Notable among these are the AICPA statements describing the independence of accountants, the scope of management advisory services, and the proper role of accountants in tax matters. Generally, large national accounting firms obtain the bulk of their business from large, publicly-owned corporations, while local accounting firms and practitioners deal mostly with privately-owned businesses and individuals. It will be seen that the AICPA consistently supports the interests of the big accounting firms, which are primarily concerned with satisfying the desires of large corporate clients.

An example of the AICPA's preoccupation with the interests of large national accounting firms at the expense of individual practitioners and local accounting firms is the demise of the AICPA's Committee on Displacement of CPA Firms. That committee was formed originally to find ways to help small accounting firms whose clients were being taken away by the large national accounting firms. Displacement of the small firms by the large ones accelerated during the period of rapidly increasing corporate merger activity which started in the 1960's, and was facilitated by the failure of the AICPA's Ac-

counting Principles Board to eliminate abusive practices used in accounting for business combinations.

Although a majority of the AICPA's members who are in public practice belong to firms with less than 10 members, almost all of the AICPA's resources are devoted to projects which primarily benefit the "Big Eight" and the other large national firms. The Committee on Displacement of CPA Firms was one of the few projects aimed at helping small accounting firms, but it was abolished by the AICPA even though the committee members believed there were areas where the committee could be useful to local accounting firms.

Perhaps the best indication of the manner in which the AICPA works to benefit the big accounting firms is the statement this subcommittee has obtained from a former member of the Committee on Displacement of CPA Firms. The former member, who is a partner in a prominent small accounting firm, has stated unequivocally that the committee was not permitted to expand its activities into meaningful areas which might benefit non-national AICPA members, and that it was abolished after completing some minor tasks which were acceptable to the leadership of the AICPA. (See Appendix K, p. 1733.) The staff of this subcommittee has been told of similar experiences with AICPA committees by other prominent AICPA members who are not affiliated with the "Big Eight" or the other large accounting firms.

Because of the varying interests of accountants on specific issues, there is no single position that can be taken by the AICPA to reflect the views of all accountants. Yet it claims to speak on behalf of all its members, representing a vast majority of the accounting profession. Although the committees which speak for it are controlled by a small minority of AICPA members from the largest accounting firms, the views and activities taken by the AICPA supposedly speak for the entire membership.

As part of its accounting inquiry, this subcommittee requested a list of the testimony and comments by the AICPA before the Federal Government since 1 January, 1975. That list may be found in Appendix E, at page 935. Although the abbreviated descriptions do not fully disclose the purpose of these activities, the list does provide some understanding of the scope of AICPA statements before Congress and Federal agencies. The list shows that the AICPA was quite active in attempting to influence the Federal Government during the 15 months covered by this subcommittee's request.

Some of the AICPA statements mentioned on the list are included in Appendix E of this study. They serve as examples of the AICPA activities described in this chapter. Interested persons may request copies of the other statements directly from the AICPA.

Several current AICPA activities are described on the following pages. They should be evaluated with the understanding that the AICPA is a big operation. In fiscal 1975, it spent over $18 million on its various activities, according to the AICPA annual report. More than $589,000 was spent to influence relations with the Federal Government. Another $187,000 was spent working on Federal taxation matters.

Large amounts were also spent on relations with other significant organizations. It cost $264,000 to promote relations with universities,

$294,000 for relations with State CPA societies, and $381,000 to influence the general public. Accountants are licensed to practice under the authority of State law, and almost $190,000 was spent on State legislation dealing with the regulation of accountants.

These substantial sums clearly show that the AICPA is no small-scale operation, and that the ability to control its resources is a definite advantage. The amounts spent influencing the Federal Government and other groups give rise to the first of the AICPA's many activities.

Political Program

According to the 16 February, 1976 report filed with the Secretary of the Senate and the Clerk of the House, the AICPA is a registered lobbyist before the Congress. The designated lobbying agent is the organization's vice president of government relations. The AICPA's efforts to lobby Congress are both well-financed and well-planned.

One example of the AICPA's political planning is a guest editorial by its vice president of government relations which appeared in the February, 1976 issue of the CPA Journal, a publication of the New York State Society of CPAs. (See Appendix E, page 964.) The article is titled "A National Political Action Program for the Accounting Profession," and outlines procedures to be followed by accountants for effective lobbying. After noting that accountants are in a distinctive position to influence Congress, the article explains the need for lobbying as follows:

> We are in a period in which the services provided by the accounting profession are taking on greater and greater economic significance, placing the profession in a more visible position to more and more segments of the public. This "new awareness" on the part of the public, and in particular the federal government as one major segment of the public, poses problems for the profession.
>
> We are witnessing today a phenomenon which has been building gradually over the last decade; that is, a growing anti-business attitude on the part of Congress. Congress and the regulatory agencies have been exhibiting a heightened interest in the effects of corporate activity on our daily lives and CPAs, being closely associated with business, both large and small, are being caught in the web of suspicion surrounding business practices. As allegations are made and investigations are conducted concerning alleged improprieties by corporations and their management, more and more attention is being focused on the CPA's responsibilities to the public and the way in which he is discharging them.

The editorial calls for legislation to limit the legal liability of accountants, and suggests a "key man" program as one method of achieving political goals. Under such a program, key members of the accounting profession are designated to establish close relationships with Members of Congress. The article concludes, "It is clear that tomorrow's decisions are based on the influence of today and that having recognized this important lesson, the profession will benefit from this increased awareness and commitment to a national political program."

It is revealing that the AICPA views valid public and congressional interest over the "greater and greater economic significance" of accounting services as "problems for the profession" and "a growing anti-business attitude on the part of Congress." Congressional efforts to clean up the massive abuses by big corporations uncovered in recent years can hardly be characterized as "anti-business." Furthermore, the AICPA unrealistically desires that accountants have "greater and greater economic significance" in our society without having to face the "problems" of public awareness on the impact of their activities.

Identifying the interests of CPAs with those of their business clients also raises questions as to the self-proclaimed independence of accountants and the actual interests they are serving. If the accounting profession is adequately performing services that benefit the public interest, it is difficult to understand the alarm over public recognition of the role played by accountants which is expressed in this editorial.

The AICPA has already started the "key man" political action program mentioned in the article. In a letter to AICPA council members, the chairman of the board of directors called a series of special regional council meetings during August, 1976 to plot strategy for dealing with Congress. (See Appendix E, p. 993.)

After claiming that "the tempo of activities in Congress that have a direct bearing on the accounting profession have increased at an alarming rate," the AICPA board chairman stated in his letter:

> There are many current developments which cause us to be alarmed about the possibility of government intervention in the profession's affairs. Much of the present interest in Washington comes from a concern about corporate accountability and an environment that is anti-business. The profession is viewed as a means of dealing with the perceived need for greater accountability.

The chairman also told the council members that an important part of the AICPA's political activities will be a "key man" program in every State to effectively communicate the accounting profession's views to their representatives in Congress. As described previously, the organizational views expressed by the AICPA reflect the views of the "Big Eight" accounting firms.

Once again, the self-proclaimed independence of CPAs from their clients is brought into question by the AICPA chairman's indentification of accountants' interests with the interests of big corporate clients. It is difficult to regard CPAs as nonpartisan auditors working in the public interest when the AICPA's chairman of the board describes congressional efforts to rectify bribery, illegal political slush funds, misleading financial information and other impediments to free enterprise as evidencing an attitude that is "anti-business."

Accountants have gained respect and prospered as a result of the Federal securities laws and other governmental actions that have required financial statements to be verified by independent auditors. Federal requirements for independent audits were necessitated by the public's need for accurate information on corporate activities which have a substantial impact on personal finances, as well as the general economy. It is interesting, therefore, to note that the AICPA's chairman describes congressional inspection of the special role it has created

for CPAs as having "the possibility of governmental intervention in the profession's affairs." The problems being studied by Congress involve the public's affairs, including the extent to which the accounting profession and Federal agencies have fulfilled the special public responsibilities given to them by Congress.

The AICPA board chairman's statement that the accounting profession is viewed by Congress and the public as a means of dealing with the "perceived need for greater accountability" also raises serious questions. Disclosures of massive wrongdoing by major corporations and their "Big Eight" auditors—some examples of which are described in this document—have demonstrated a very real need for greater corporate accountability. Congress, the courts, the SEC, and private shareholders have been involved in efforts to achieve greater accountability by corporate managements for their activities. Those efforts depend on accurate information and effective independent auditing. The accounting profession evolved originally because of a need for greater accountability over business activities, so it is natural that the Federal Government and the public regard independent auditing as an instrumental part of efforts to improve corporate accountability.

The same theme expressed by the AICPA is sounded in another article in the February, 1976 issue of the CPA Journal. (See Appendix E, page 961.) This article, by two accounting professors, is titled "Are Congressionally-Regulated Accounting Principles Desirable?" It speaks of "congressional interference" and concludes: "To be heard by Congress, we believe the members of our profession must become a political force, a political force to keep the politicians out of the accountants' precinct."

The mood of the AICPA on political and other matters is most succinctly stated, however, by a guest editorial in the March, 1976 issue of the CPA Journal. (See Appendix E, page 968.) The editorial is titled "Looking to the Future," and was written by a past president of the AICPA. He is now on the AICPA council and is a senior partner at Alexander Grant & Co., one of the 15 largest accounting firms.

The editorial takes the form of a series of recommendations to "those who will have the responsibility for charting the future course of our profession." The first rule to be observed is, he says: "Strive to keep the setting of principles and standards in the private sector—at all costs." The presumed validity of this statement is apparently so strong that the author does not justify it with reasoning or further elaboration. The efforts and effects of the private sector's standard-setting ventures are described in subsequent parts of this study.

The editorial also recommends that accountants be wary of additional disclosure requirements, and "get the IRS and the Congress to take some cognizance of current value accounting in the tax laws and regulations as is the case in Brazil and Chile . . ."

Another recommendation reflects a continuous theme in AICPA literature and activities: "Strive for a mitigation of accountants' legal liability; support the efforts being directed toward quality control programs; strive to educate the public on auditors' responsibilities." The apparent contradiction in urging higher quality standards for accountants while simultaneously attempting to limit the legal lia-

bility of accountants who deviate from the standards is well-accepted in AICPA policy statements.

The AICPA is very definitely a political organization with a well-financed effort to influence Congress and other groups, both on matters relating to accounting and unrelated matters of political interest to the business sector.

Influencing Federal Tax Policy

Influencing Federal tax policies and procedures has been one of the most important goals of the AICPA, and substantial time and resources have been devoted to achieving that goal. The AICPA has regularly submitted testimony and statements to the House Committee on Ways and Means, the Senate Committee on Finance, and the Senate Select Committee on Small Business. Additional statements are directed to the IRS and other relevant agencies.

The AICPA biennially prepares a booklet entitled "Recommended Tax Law Changes" which it distributes to all Members of Congress.

Four "Statements of Tax Policy" have also been prepared and distributed by the AICPA. These attractive booklets present the official AICPA views on controversial tax issues under the following titles: "Taxation of Capital Gains," "Value-Added Tax," "Elimination of the Double Tax on Dividends," and "Estate and Gift Tax Reform." Because of their length, these booklets are not included in this study; however, the views expressed in them are covered to a large extent by the following statements.

Two AICPA statements on tax problems of small businesses were submitted to the Senate Select Committee on Small Business on 28 February, 1975 and 13 November, 1975. The recommendations of the AICPA on several highly political and controversial tax issues consistently support more tax benefits for the accounting profession's business clients.

The AICPA recommendations contained in those two statements can be summarized as follows:

> A permanent increase in the investment tax credit, including increases in the rate as well as in the types and amount of property which will qualify for the credit;
>
> A reduction in the corporate tax rates, both the regular rate and the surtax rate;
>
> An increase in the corporate surtax exemption;
>
> An increase in the minimum accumulated earnings credit, allowing businesses to retain a larger portion of their earnings in their business;
>
> Retention of accelerated depreciation methods and further liberalization of capital recovery methods; and
>
> Elimination of "dual taxation" which taxes both corporate earnings and distributed dividends.

The chairman of the AICPA's Federal Tax Division testified before the House Ways and Means Committee on 15 March, 1976. The synopsis of the AICPA position briefly summarizes its recommendations on estate and gift tax reform. (See Appendix E, p. 981.)

Finally, the AICPA's summary statement on tax revision before the Senate Finance Committee on 18 March, 1976 presents a concise view of its position on several tax-related matters. (See Appendix

E, p. 985.) In addition to liberalizing the taxation of capital gains and eliminating the "double tax" on corporate dividends, the statement on tax revision also recommends continuation of a tax *credit*, rather than a tax *deduction*, for the amount of foreign taxes paid. Regulation of income tax preparers—other than CPAs and attorneys—is also urged, along with a recommendation that only limited essential facts of private tax rulings by the IRS be disclosed to the public.

A review of the AICPA's statements before Congress shows no hesitancy on the part of the representatives of the self-described "independent" accounting profession to openly advocate more tax benefits for the corporate business sector. In fact, the major AICPA recommendations vary little in substance from those of the recognized business lobbying organizations, such as the National Association of Manufacturers and the Financial Executives Institute. Phrases such as "capital shortage," "need to stimulate business," and "bias against equity investment" abound in AICPA statements.

The AICPA has clearly failed to recognize any distinction between trying to achieve more efficient application of existing tax laws and trying to influence tax policies regarding the proper sources of tax revenues. The clients of local accounting firms and practitioners are primarily concerned with the efficiency of existing tax laws since they are unable to affect tax policies on much more than an individual basis. The large corporate clients of the big accounting firms, however, have their own lobbyists and industry groups who are actively engaged in promoting the political interests of big business. The control of the AICPA operating structure by the "Big Eight" accounting firms may explain the partisan business views taken as the official AICPA position.

The AICPA also submitted a statement and testimony on Federal tax return confidentiality to the Privacy Protection Study Commission on 5 March, 1976. Along with its general endorsement for strict confidentiality of individuals' tax returns, the AICPA urged that corporations should also be permitted greater secrecy concerning their tax affairs, and that the increased protection afforded to individuals should be extended to corporations, trusts, and estates. The AICPA statement concludes with a call for legislation that would grant a privilege to accountants similar to the attorney-client privilege which now prevents forcing disclosure of certain matters revealed by a client to his attorney. The need for creation of an accountant-client privilege is another recurring theme in AICPA literature.

In a related move, the AICPA recently appointed a special committee on privacy legislation. The committee is charged with monitoring and analyzing proposed privacy legislation as to how it may affect AICPA members and their clients' data systems. Significantly, five of the 10 committee members are from "Big Eight" firms. Another three members, including the chairman, are from the next seven largest accounting firms, meaning that 80 percent of the committee membership are representatives of the 15 largest accounting firms.

Other Congressional Lobbying

An example of other AICPA lobbying before Congress is an AICPA position paper on the procurement of CPA professional services by the

Federal Government, which was submitted to a subcommittee of the Senate Government Operations Committee on 15 April, 1976. As might be expected, the AICPA endorses the use of CPAs to provide both auditing and management advisory services to the Federal Government.

The AICPA explains, however, that it is very difficult to determine in advance the amount of services which a CPA must perform to satisfy his contractual and professional obligations. Therefore, the AICPA strongly recommends that fixed-price contracts for CPA services be abandoned and replaced with contracts which guarantee payment for all materials and time expended by a CPA, no matter what that may encompass. According to the AICPA, the Federal Government "misleads itself" by awarding contracts on the basis of low price instead of cost-plus contracts which permit a contractor to respond fully to government needs "without financial penalty."

The AICPA statement warns that professional CPA services soon will not be available to the Federal Government unless all known and unknown time and materials charges are guaranteed from the start of a contract. Special government selection boards staffed with "qualified" persons are recommended by the AICPA to select as final bidders only the firms which have the proper "qualifications." In addition to urging restriction of unlimited competition for bids on Federal contracts, the AICPA states that a government agency should "indicate the price range it has in mind" so that prospective contractors will know how much to bid. The AICPA counsels that "this information allows offerors to tailor their proposals in a manner consistent with agency resources . . ." Bidding for Federal contracts will certainly be easier if the amount the government wants to spend is known in advance.

Another recent AICPA lobbying activity was the successful effort to block a congressional directive that the SEC adopt uniform accounting standards for oil and gas companies. Rep. John Moss of California had introduced an amendment to the Energy Policy and Conservation Act (H.R. 7014) directing the SEC to exercise the accounting authority given to it by Congress over 40 years ago. Along with the SEC, the AICPA was instrumental in changing the legislative language so that the SEC would merely perform its usual practice of following the accounting standards set by the private sector through operation of the Financial Accounting Standards Board. Two letters outlining the AICPA's objections to the Moss amendment—one to Representative H. John Heinz of Pennsylvania and one to Representative Moss—are contained in Appendix E, at pages 971 and 976.

The AICPA was primarily concerned that GAO audits of oil and gas companies would supplant CPA audits of the same companies and that the premier role of the AICPA in setting accounting standards would be undermined. The activities of the AICPA and FASB in setting accounting standards are described elsewhere in this study. The notable point here is that the AICPA lobbied intensively to defeat a proposal to have accounting standards set by an agency responsible to the public, rather than by the private groups under the control of the AICPA which have determined accounting standards in the past.

In his letter to Representative Moss, the chairman of the Board of the AICPA stated: "We agree that Congress should be assured that uniform accounting standards are developed for the petroleum industry within a reasonable period of time." He then went on to urge that

such accounting standards be determined in the private sector by the FASB in order to "preserve the spirit of cooperation between the public and private sectors which has served the public well over more than forty years."

The AICPA's board chairman did not mention that the failure of the private sector to develop uniform accounting standards over more than 40 years was the very reason legislation by Congress was necessary to achieve that goal. The AICPA has continually extolled and promoted the "virtues" of setting accounting standards in the private sector, while failing to develop meaningful uniform accounting standards through the organizations it controls. This is yet another of the contradictory positions assumed by the AICPA.

The close working relationship between the AICPA and the SEC in determining accounting standards has apparently been quite satisfactory to both parties. By delegating its statutory authority to set accounting standards to private groups controlled by the AICPA, the SEC has absolved itself of the responsibility for making difficult decisions on developing accounting standards in the public interest. In return, the AICPA has received a grant of Federal recognition and approval for the accounting standards developed by the committees and boards it controls.*

The AICPA and its members are in the unique position of determining what accounting standards shall be, applying those accounting standards for the benefit of their clients, and having the accounting standards they develop and apply officially recognized as authoritative by the SEC. This remarkable situation is somewhat akin to permitting the American Bar Association to make the antitrust laws which its members must apply to their corporate clients with the official approval of the Justice Department and the courts. Understandably, the AICPA is careful to protect its enviable relationship with the SEC.

An example of its protective efforts is the letter sent to Senator Philip Hart of Michigan as chairman of the Subcommittee on Antitrust and Monopoly. (See Appendix E, at page 973.) The AICPA advised Senator Hart of the SEC's wisdom in setting into motion "a most successful mechanism to accomplish the complex task of setting accounting and disclosure standards."

The AICPA letter also notes the SEC's awareness that it is "fiscally impractical" for a public agency to undertake the complex business of setting accounting standards. The AICPA concludes by recommending an amendment which would delete a section of the Antitrust Improvements Act of 1975 giving the Federal Trade Commission certain authority to prescribe accounting methods. Despite the allegations of the AICPA, Chapter X of this study dealing with the Cost Accounting Standards Board (CASB) suggests that public agencies are able to set accounting standards. (See page 184.)

Liaison With the Cost Accounting Standards Board

As previously described, the AICPA has a special committee to deal with the CASB. In addition to meeting with the CASB and

* For an elaboration of the SEC's relationship to the AICPA and other accounting groups, see "Corporate Financial Reporting—Public or Private Control" by Professor Robert Chatov, the Free Press, a division of Macmillan Publishing Co., Inc. (1975).

working with its staff, the committee prepares official AICPA comments on actions proposed by the CASB. The committee has been so successful in its efforts to influence CASB activities that the CASB has chosen the AICPA to receive its "public service award." The propriety of the CASB presenting a public service award to a professional lobbying organization is discussed under the section describing the CASB. (See p. 186.)

The CASB sets accounting standards which measure and allocate what costs may be properly charged to the Federal Government by private contractors performing Federal contracts. Defense contractors and others advocate a broad definition of cost because it increases payments received from the Federal Government. Money received for payment of costs also does not appear in the profit category which is subject to readjustment.

The AICPA has not confined its efforts to commenting on technical application of CASB proposals. Instead, the AICPA has actively advocated the views of its members' corporate clients on several controversial areas of Federal contracting policy. The following examples demonstrate how the AICPA has used the reputation of CPAs for independence to promote the political interests of government contractors on issues involving public policy judgments.

The first example concerns the 29 April, 1975 statement and accompanying letters of the AICPA on the CASB's proposal to require that actual useful lives of assets be used in computing depreciation as a cost to be allowed on Federal contracts. Government contractors prefer that artificially short asset lives be used so that depreciation charges are greater, and more money is received in the "cost" category from the Federal Government.

The AICPA comments to the CASB state general agreement with the latter's proposal that use of actual asset lives is more realistic in computing depreciation to determine real costs. However, the AICPA expresses concern that the CASB might unduly limit use of accelerated depreciation methods which allow fast write-offs of assets used by contractors in performing Federal contracts. Without accelerated depreciation, contractors would not be able to charge the bulk of an asset's value as a cost to the Federal Government in the first years of an asset's actual life.

The AICPA also warns that the CASB is not protecting government contractors from inflation by insisting on the use of real asset lives to compute proper depreciation charges. The AICPA and several of the largest accounting firms are engaged with much of the business community in a concerted campaign to adjust the accounts of businesses for the alleged effects of inflation. The purpose of the campaign is to guarantee the purchasing power of the business sector through changes in accounting methods which will lead to lower business taxes and greater cost allowances by government authorities.

Another example of the AICPA's efforts to influence the CASB is the 14 January, 1976 letter of comment on the CASB's proposal to achieve uniform accounting for direct and indirect costs associated with Federal contracts. Standard-setting bodies controlled by the AICPA have never achieved uniform accounting standards. The AICPA recommends to the CASB that exact, uniform standards are not necessary, and that broad definitions are sufficient to guide the

many accounting systems developed by government contractors. The AICPA concludes: "Any attempt to require a system of common cost accounting among all contractors will be costly and counterproductive."

The views expressed by the AICPA echo the original arguments against the creation of the CASB. In establishing the CASB, Congress recognized that the key to sound Federal procurement is a system of meaningful and comparable accounts. The failure to establish uniform standards for financial accounting has caused great confusion among users of financial statements and substantial financial losses for many investors. Once again, the position taken by the AICPA is in opposition to the efforts by Congress and Federal agencies to develop efficient accounting practices.

A final example shows the AICPA supporting the allowance of "costs" which are not costs at all in normal business jargon. The CASB proposed to recognize a certain portion of contractors' return on invested capital as a "cost." Normally, any return on contractors' invested capital is considered to flow from earned profits.

Paying a return on capital as a "cost" obviously deviates from all accepted business practices, except for those of regulated utilities. The AICPA recognized the departure from commonly understood business concepts, but argued that return on capital is an economic cost and should thus be charged to the Federal Government as an operating "cost." The AICPA position is concisely stated on the first page of its 2 February, 1976 letter to the CASB: "We believe the standard ultimately promulgated should treat 'cost of money' explicitly as a contract cost as opposed to recognition through pre-negotiation profit objective."

This controversial name-change for earnings on Federal contracts increases payments to contractors, further removes risks from Federal contracts and provides government contractors with yet another advantage over competitive businesses in the private sector. It should be noted that the additional "costs" to be charged the Federal Government are not recognized as costs for computing Federal income taxes or reporting profits to the public, but only for seeking increased Federal payments. Not only did the AICPA support this departure from the goal of a single accounting system and normally accepted concepts of profit and cost, but it urged the CASB to use an even larger standard of measurement to increase the amount of profits recovered as "costs." The AICPA also encouraged the CASB to consider more accounting adjustments which would pay for the alleged effects of past and current inflation. Partisan statements on controversial policy issues are an integral part of the AICPA's relations with the CASB.

Liaison With the Securities and Exchange Commission

Several AICPA committees attempt to influence the SEC. Because the SEC has statutory authority to set accounting standards and disclosure rules for publicly-owned corporations which are the major clients of large accounting firms, the AICPA becomes involved in all SEC activities that may affect the manner of practice preferred by large accounting firms and their corporate clients. Two recent ex-

amples illustrate the type of concerns expressed to the SEC by the AICPA.

The first is the statement submitted by the AICPA in response to SEC Release No. 33–5569. (Disclosure with Respect to Compliance with Environmental Requirements and Other Matters.) In its proposal, the SEC was seeking comments on the amount of information which corporations should be required to disclose publicly regarding compliance with environmental, equal opportunity, health and other social benefit legislation. The SEC has been primarily concerned with disclosure of financial information in the past.

The position taken by the AICPA on corporate disclosure of social impact data is something of a paradox. The AICPA notes that collection and presentation of social impact data is still relatively primitive, and concludes:

> Except in areas in which information requirements are specified by regulatory agencies, the quantity and quality of information varies enormously if, in fact, it exists within the registrant at all. Progress in social measurement can be expected in these areas, but initially at least nothing beyond 'encouragement to report' should be contemplated except, perhaps, in areas where governmentally established requirements exist.

In other words, the AICPA states that meaningful data on important social issues exists only where government regulatory agencies have required it to be collected. The AICPA then counsels the SEC—a government regulatory agency—merely to encourage corporations to report social impact data, rather than require that it be done. This paradoxical approach suggests that the government agency charged with setting proper disclosure standards should not exercise its authority because meaningful disclosure will not result unless a government agency sets proper disclosure standards. The peculiar logic supporting certain AICPA policy recommendations is sometimes confusing to outside observers.

There are also some contradictions in the second recent example of the AICPA's efforts to influence the SEC. This example involves the attempt by the AICPA to have the SEC withdraw a rule which requires an accountant to state whether a client's change of accounting principles is preferable under the circumstances. The AICPA coupled an elaborate supporting statement with a request that the SEC act to remove the "preferability" rule in its 23 April, 1976 statement to the SEC.

The AICPA argued that accountants could not make a valid judgment on whether one of several available accounting principles was preferable to others because there are no definite standards to apply. Furthermore, the AICPA stated that the "preferability" rule requires individual CPA firms to act in a capacity that is properly the role of a constituted authority that can set accounting standards. Existing auditing standards are sufficient for identifying unwaranted changes in accounting principles, according to the AICPA statement.

The SEC rejected the AICPA's request on the grounds that it is reasonable to expect an accountant to make a judgment on the preferability of accounting principles, and users of financial statements should have the benefit of the accountant's judgment. The SEC stated

that one of the fundamental professional responsibilities of an independent accountant is to apply his skills and trained judgment in economic measurement to particular factual circumstances, to determine whether the circumstances are fairly accounted for within the accounting model.

The AICPA's request to reduce the responsibilities of accountants by withdrawing the SEC's "preferability" rule seems contradictory when considered in conjunction with other AICPA activities. For example, standard-setting bodies controlled by the AICPA have operated as the "constituted authorities" to set accounting standards for over 40 years. During all that time, the AICPA has not promulgated a consistent set of accounting standards to provide uniform accounting treatment for the same type of transactions. As a result, there are often several different accounting principles which can be applied to a single transaction to show wholly different outcomes.

Yet, in a section of its statement titled "The CPA's Dilemma," the AICPA laments that no authoritative body has been able to decide upon the nature and content of optimally useful accounting information. After stating that it is thus unfair to require individual accounting firms to express an opinion on the preferability of accounting principles, the AICPA concludes: "Users can only benefit from the development of uniform standards that will result in similar and consistent judgments by all CPAs in similar circumstances."

In view of the fact that the AICPA and its members have been in a position to develop uniform accounting standards for more than 40 years, it is difficult to understand the "CPA's dilemma" as explained by the AICPA. Any dilemma over application and choice of accounting standards is self-imposed.

Another contradiction is posed by the AICPA's effort to reduce the significance of an accountant's opinion while continually promoting the value of opinions by accountants on many diverse subjects. The alleged inability of CPAs to judge preferable accounting principles is sharply at odds with the AICPA's constant efforts to expand reliance on and the use of judgments by accountants in both governmental and business activities. The promotion of CPA abilities to analyze facts and render opinions is a central theme throughout the spectrum of AICPA literature and activities.

For instance, the AICPA sent its position paper on national health insurance to the members of the appropriate congressional committees on 23 June, 1975. While professing to be neither for nor against the concept of national health insurance, the AICPA does have several recommendations on how such a program should be administered. Not surprisingly, one of the chief recommendations is a requirement that the financial statements of organizations providing national health program services be examined annually by a CPA in accordance with generally accepted auditing standards.

The objective of the recommended audits would be to enable a CPA to express an opinion—for which he would assume professional responsibility—that the financial statements fairly presented the financial position of an organization. As stated by the AICPA:

> There are important benefits to be derived from independent audits. The most significant would be the independent accountant's opinion on the provider's financial statements.

> All interested individuals or groups would benefit from this opinion, for without it all they have to rely upon are the representations of management.

Several of the paragraphs used in the official description of CPA services contained in the AICPA bylaws also portray a "distinctive role" played by CPAs in furnishing objective advice, reviewing activities and procedures, and expressing independent opinions. (See Appendix E, page 998.)

The AICPA sometimes takes a position on both sides of an issue, depending on the purpose to be achieved by espousing a different position to different parties. With respect to official requirements on the responsibilities of independent auditors as promulgated by the SEC, the AICPA takes the position that only limited results can be expected from the auditing and accounting functions performed by CPAs. When addressing clients, potential clients and the public, however, the AICPA convincingly portrays the almost boundless benefits of services performed by accountants. The confusion which exists over the exact role of CPAs has undoubtedly been due in large measure to the conflicting views of the AICPA itself.

Self-Regulation

In response to public criticism and adverse decisions by the SEC and the courts, the AICPA has recently provided three important examples of its self-regulatory efforts. These efforts are notable because they demonstrate the type of solutions the AICPA regards as suitable to handle the problems which face the accounting profession. Self-regulatory procedures established by the AICPA are also very important to the public because they determine the quality of information which the public receives on business activities from financial statements certified by accountants.

The first example is the voluntary quality control review program for CPA firms practicing before the SEC. These are primarily larger accounting firms with many publicly-owned clients that are subject to SEC reporting requirements. The voluntary quality control review program was adopted by the AICPA at its May, 1976 meeting of the council. The text of the program is contained in Appendix E, at page 1000.

The purpose of the voluntary quality control review program is to establish an inspection system to certify that auditing procedures followed by accounting firms practicing before the SEC are worthy of public confidence. The AICPA's answer to the question of who shall ensure that large accounting firms are operating competently has serious deficiencies. Those deficiencies largely undermine the stated objective of the quality control review program, which is to improve the performance and credibility of the accounting profession. The major deficiencies are listed below:

> The program is entirely voluntary. No protection is provided for those who must rely upon accounting firms which do not participate in the program.
>
> Accounting firms participating in the program can freely leave or re-enter the program. While participating firms are permitted to identify themselves publicly as participants in the quality con-

trol review program, no public notice is given when their participation is terminated.

Participating firms are judged by each other, either through selection of a particular CPA firm to handle the quality review, or through review by a team of representatives from other participating firms. When making judgments, reviewers must surely be aware that their firms are also subject to review judgments by other participants.

A firm participating in the quality review plan is not required to give reviewers access to files on all audit engagements.

The reviews are to be conducted in accordance with standards approved by the AICPA's Auditing Standards Executive Committee. As shown previously on page 90, the chairman and two-thirds of the members on that committee came from the 15 largest accounting firms. Those firms will undoubtedly be the principal participants in the review program, and will have a direct interest in the effects of the standards they approve.

Some of the "Big Eight" firms have previously arranged to have another "Big Eight" firm review them for quality assurance. Last year, Peat, Marwick, Mitchell & Co. retained Arthur Young & Co. to review its operations. Arthur Young & Co. produced a favorable report on that firm's quality of practice, although Peat, Marwick, Mitchell & Co. had been disciplined by the SEC for numerous accounting abuses. (See Appendix C, page 736.)

This year, Arthur Andersen & Co. and Price Waterhouse & Co. have retained Haskins & Sells to conduct quality reviews of their firms. The trustee in bankruptcy for the Equity Funding Corporation of America has found that Haskins & Sells "must share significant responsibility for the persistence of the fraud at Equity Funding." (See Appendix C, page 721.) The trustee's description of faulty auditing procedures followed by Haskins & Sells may cause the public to question the usefulness of a Haskins & Sells opinion on the quality of practice at other accounting firms.

Mutual review of each other's work by the "Big Eight" is an inadequate regulatory tool, especially when the reviewers' own auditing practices are questionable. Several examples of improper auditing and accounting by "Big Eight" firms have already been brought to public attention through actions in the courts and by the SEC. Other cases are pending. Some of the publicly-known examples are mentioned in the portion of this study that deals specifically with the activities of the "Big Eight" accounting firms. (See page 54.)

The other two recent examples of the AICPA's self-regulatory efforts are the exposure drafts issued by the Auditing Standards Executive Committee on 30 April, 1976. The purpose of these proposed position statements is to provide guidance for accountants on matters which have created substantial controversy. The first is a proposed AICPA position statement on the independent auditor's responsibility for the detection of errors or irregularities. The second is a companion proposal on the manner in which accountants should treat illegal acts by clients. (See Appendix E, pages 1009 and 1015.)

Examination of the two AICPA proposals on illegal acts by clients reveals that much of the proposed guidance is actually for the SEC, the courts, and persons who have been damaged by illegal acts that

were undetected or unreported by independent auditors. The guidance for these outside parties is that they should not expect too much from an audit performed in accordance with generally accepted auditing standards (GAAS). The theme that an audit in accordance with GAAS cannot be expected to provide assurance that illegal acts have not occurred is reiterated throughout the two proposed position statements.

There is some realization in the proposals that the training and functions performed by independent auditors should enable them to discover illegal acts, or at least the "material" ones. In this regard, the second proposal states that an auditor should ask clients about possible illegal acts in the hope of learning about government investigations or enforcement proceedings.

Such proceedings may involve violations of laws with respect to occupational health and safety, food and drug administration, securities, truth in lending, environmental protection, price-fixing or other antitrust practices. Of course, the public is not benefitted by the findings of independent auditors if governmental agencies are already aware of irregularities.

Nevertheless, the proposed AICPA position is that if the independent auditor does not learn of governmental proceedings, or the client's management does not tell the auditor of illegal acts, then the auditor cannot reasonably be expected to discover violations of the types of laws and regulations which have just been described.

The second proposal concludes:

> . . . The laws and regulations governing those matters are highly specialized and complex. Also, they normally relate to the operating aspects of an entity rather than its financial or accounting aspects. Consequently, determining compliance with such laws and regulations is outside the professional competence of independent auditors.

This proposed AICPA statement on the inability of accountants to make determinations on non-accounting matters conflicts with the AICPA statements before Congress on the many benefits which will flow to the Federal Government from using a full range of accounting and non-accounting services performed by CPA firms. It also conflicts with AICPA statements to the public on the ability of CPA firms to provide a wide range of management advisory services unrelated to accounting and auditing. Most of all, however, it conflicts with the official AICPA description of the professional practice of CPAs which is contained in the bylaws:*

> CPAs have a distinctive role in examining financial statements submitted to investors, creditors, and other interested parties, and in expressing independent opinions on the fairness of such statements. This distinctive role has inevitably encouraged a demand for the opinions of CPAs on a wide variety of other representations, such as compliance with rules and regulations of government agencies, sales statistics under lease and royalty agreements, and adherence to covenants in indentures.

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* See Appendix E, page 998 for full text.

Thus the question of CPA competence to make determinations on nonaccounting matters is another area where the AICPA will take contradictory positions if the proposal on illegal acts by clients is adopted. Although the AICPA apparently believes that the public does not understand the role of the independent auditor, there is ample question as to whether the AICPA has a better-defined concept of the auditor's responsibilities than has the public.

There are other problems with the two proposed AICPA statements on illegal acts by clients. One is the recommendation in the first proposal that an accountant adjust the degree of auditing tests and confirmations needed to verify data according to the accountant's own evaluation of the client's integrity and reliability. That recommendation tends to permit a lesser amount of independent checks and confirmations for records and information supplied by well-established companies with good reputations. Many of the greatest abuses uncovered during the past few years, however, have been committed by well-known corporations with established reputations. Those abuses demonstrate that stringent auditing procedures should be applied to all clients, regardless of size or reputation.

THE "MATERIALITY" STANDARD

Another problem with the two proposals on illegal acts by clients is the test of "materiality" which pervades all accounting and auditing standards. The AICPA has long determined that only "material" acts by clients should be disclosed, and the same test is proposed for reporting illegal acts. Recently, the AICPA proposed that the standard of "materiality" should be five percent. (See page 121.)

The inconsistency in that standard of measurement is that small companies with limited influence may be required to report illegal or improper expenditures of a few thousand dollars because such amounts are deemed "material" to their operations. Giant multinational corporations exercising great influence, however, may avoid disclosing many millions of dollars in illegal or improper expenditures because such amounts are deemed "immaterial" to their billion-dollar operations.

The relative test of "materiality" equates bigness with goodness. It does not recognize the absolute value of significant amounts of money, and permits large corporations to do things which have substantial impact in absolute terms because the amounts involved may not be "material" to total corporate operations. Because of the "materiality" test used in applying auditing and accounting standards, big corporations are held to a lower absolute standard of accountability than smaller companies.

In following the guidelines proposed by the AICPA on illegal acts, there is no requirement that an independent auditor report such acts to government authorities. In fact, there are no requirements that an independent auditor do anything at all. Instead, there are several suggestions that an auditor should "consider" such things as qualifying his opinion or withdrawing from the audit engagement.

The AICPA proposals mention only that illegal or improper activities should be reported to appropriately high levels of a client's management. The most remarkable statement in the second proposal is

that auditors are not responsible for reporting illegal acts to the proper government authorities: "Deciding whether there is a need to notify outside parties of an illegal act is the responsibility of management. In the ordinary case, the auditor is under no legal obligation to notify outside parties."

The second AICPA proposal does suggest that auditors seek legal advice when deciding which illegal acts are "sufficiently serious" to consider taking some other action. All citizens—including accountants—have a legal or moral duty to report illegal acts which come to their attention. A professional standard which seeks to require less from independent auditors than from other citizens does not promote the alleged benefits of self-regulation.

In the wake of continual revelations of massive illegal activities by major corporations, the AICPA proposal that accountants should rely upon corporate managements to report their own illegal acts is truly extraordinary. It raises serious questions about the self-defined role of auditors for publicly-owned corporations. Not only does it cast doubt on the independence of auditors from corporate managements, it also raises questions about the effective application of the securities laws which Congress has enacted for the benefit of investors, creditors, government, and the public at large. If the accounting profession is unable to determine through self-regulation that independent auditors of publicly-owned corporations owe their professional allegiance to the public, then Congress must find effective alternatives to protect the public interest. The AICPA proposals on illegal acts by clients do not establish responsible standards to guide CPAs in serving the public interest. Instead, they aid corporate managements in pursuing their own self interests.

Study Commissions

The AICPA establishes study commissions to analyze major conceptual problems facing the accounting profession and make recommendations on acceptable solutions to those problems. The AICPA selects members of commissions from what it considers to be a broad base of representation—from the accounting profession and various interest groups such as major corporations, securities lawyers, and stockbrokers.

Perhaps the most famous AICPA study commission was the Study on Establishment of Accounting Principles, better known as the "Wheat study group" after its chairman, Francis M. Wheat, a former member of the SEC. The Wheat study group was formed by the AICPA to find a more efficient and credible way to set accounting standards in the private sector. Two AICPA committees—the Committee on Accounting Procedure and the Accounting Principles Board—had failed over a period of 35 years to resolve major accounting issues and establish meaningful accounting standards.

The Wheat study group issued its report, titled "Establishing Financial Accounting Standards," in March, 1972. The report recommended establishment of the Financial Accounting Standards Board, and its recommendations were followed by the AICPA in conjunction with other interest groups. The operation and organization of the FASB is described beginning on page 130 of this study.

The AICPA formed another similar group to analyze and recommend what the objectives of financial statements should be. That group issued its report, titled "Objectives of Financial Statements," in October, 1973. The broad policy objectives of that group are being studied further by the FASB.

THE COHEN COMMISSION

The most recent study group formed by the AICPA is the Commission on Auditors' Responsibilities. The task of this group is to examine the entire social framework within which accountants operate, and to recommend solutions to problems perceived by AICPA members. This group has former SEC Chairman Manuel F. Cohen as its chairman. The Cohen commission has been pursuing its objectives for over 18 months and still has a significant amount of work to do.

Like the previous AICPA study groups, the Cohen commission is comprised entirely of representatives from large accounting firms, large law firms, large investment firms, large corporations, and academic accountants, some of whom have ties to the "Big Eight" accounting firms. The AICPA is financing the entire study. Unlike the other commissions, however, the word "independent" has been specifically included by the AICPA in its description of the Cohen commission. That may be an attempt to bolster the credibility of the commission, but the designation chosen by the AICPA does not alter the fact that the Cohen commission has been selected and is entirely financed by the AICPA, just like any other AICPA committee. Almost $1 million in expenditures is projected.

Some indications of the direction being taken by the Cohen commission can be found in the AICPA's description of its work and a recent speech by its chairman.*

The AICPA's description of the Cohen commission includes the text of the charge given to it by the AICPA's board of directors when the commission was established. The charge states that the Cohen commission is to develop recommendations regarding the "appropriate responsibilities" of independent auditors and what the public should "reasonably" expect them to accomplish. There is also an admonition that the commission should recognize the "constraints" placed on independent auditors, and that proper responsibilities of auditors should not be confused with proper results.

In his address to the AICPA on the tentative findings of the commission, Chairman Cohen stated that its final conclusions will be "consistent with a realistic conception of the independent auditor's role in society." He noted the "widespread misunderstanding" which has resulted because the public and the courts have accepted at face value the assertion in the independent auditor's certification statement that financial statements "present fairly" the results of corporate activities. He also provided assurance to the AICPA of final recommendations which will clearly convey that financial statements are actually representations of a client's management, and that distinctions must be drawn between the independent auditor's responsibility

* The AICPA's description of the purpose, organization, membership and financing of the Cohen commission appears in Appendix E, p. 917. Chairman Cohen's recent address to the council of the AICPA, concerning the progress of the study on auditors' responsibilities, appears in Appendix E, p. 1020.

for detecting illegal acts and his responsibility for disclosing illegal acts.

Some of the questions posed by the AICPA for solution by the Cohen commission seem to indicate the answer which should be given. For example: "Should the auditor's standard report, particularly the phrase 'present fairly,' be changed to express better the responsibilities of auditors?" or "What should the profession do to reduce the risks of misunderstanding about its role?"

The impact of those questions has been recognized by Chairman Cohen. He has told the AICPA of "disturbing evidence" that many investors view the auditor's report as a "Good Housekeeping Seal of Approval." The Cohen commission plans to find better ways to communicate to the public what should be expected from independent auditors in relation to the costs and benefits of audits. The chairman also notes that the work of the commission will be expedited because of the additional manpower being generously provided by four of the "Big Eight" firms: Arthur Andersen & Co., Arthur Young & Co., Coopers & Lybrand, and Peat, Marwick, Mitchell & Co.

In keeping with the AICPA's approach toward areas where accountants have failed to meet the expectations of the courts, the SEC, Congress, and the general public, the Cohen commission appears to be analyzing ways to lower the expectations of those who rely upon the accounting profession for verification of information. Rather than upgrading accounting practices to meet the real public needs for independent verification of financial information, the AICPA efforts are directed toward re-orienting everyone who uses information certified by accountants. If accountants cannot or will not perform the function of meaningful independent certification, there are questions as to who will perform that necessary service, and what value, if any, there is to society from the money it spends on the limited-responsibility audits envisioned by the AICPA.

Accounting Research Association

The Accounting Research Association is an AICPA organization which channels money from the AICPA and major accounting firms to the AICPA-controlled Financial Accounting Foundation (FAF) for supporting the operations of the Financial Accounting Standards Board (FASB). The Accounting Research Association has pledged to raise at least $2 million annually as the accounting profession's share of the funds needed to operate the FASB. Contributions to the Accounting Research Association and the FAF are tax deductible, so the taxpayer partially subsidizes the FASB.

A description of the Accounting Research Association has been prepared by the AICPA at the request of this subcommittee. (See Appendix E, page 877.) A copy of a financial solicitation letter and accompanying brochures from the Accounting Research Association is also contained in Appendix E, at page 1035.

Although substantial, the $2 million annual pledge by the Accounting Research Association has been successfully met so far. According to the sliding scale for dues, the "Big Eight" contribute $200,000 each, for a total of $1.6 million or 80 percent of the $2 million annual pledge. Most of the remaining $400,000 is contributed by other large account-

ing firms. A detailed list of contributors has been prepared by the FASB. (See Appendix H, page 1233.)

Thus, the "Big Eight" and other large firms not only control the activities of the AICPA through domination of its committees and power structure, but also directly finance the FASB by providing the bulk of the accounting profession's contributions. Their financial influence is in addition to the influence they exercise over the selection of FASB members through AICPA control over the FAF. The organization and financing of the FAF and FASB are described fully beginning on page 130 of this study.

FASB Advocate

The AICPA advocates its views on accounting issues before the FASB. A recent example is the AICPA's comments on "materiality" as reported in the June, 1976 issue of the AICPA's Journal of Accountancy:

ASD TASK FORCE COMMENTS ON FASB'S MATERIALITY PROPOSAL

In a letter to the Financial Accounting Standards Board, the Institute's accounting standards division task force on materiality said it believes that an FASB Statement establishing materiality criteria should be issued at this time. But the ASD task force added that such a Statement would, perhaps, need to be reconsidered upon issuance of a Statement on the objectives of financial statements.

The division's letter offered its views on the FASB discussion memorandum, "Criteria for Determining Materiality" (issued in March 1975). Among the division's more specific conclusions are:

The Statement should be developed from the viewpoint of the preparers of financial statements and should guide them to more consistent materiality decisions.

Materiality criteria should be based on the magnitude or financial effect of the matter and should be viewed in relative amounts. An absolute amount cannot be considered material unless its relative effect is known.

Quantitative criteria should be established and should be based on the assumption that an amount equal to five percent or more of key financial statement captions (i.e., "current assets," "income from continuing operations," etc.) may reasonably be presumed to be material.

There should be a presumption (which could be overcome in individual cases) that an item is material if the quantitative criteria are met.

It is not feasible to formulate quantitative materiality criteria based solely on earnings trends.

The AICPA's relative standard for measuring materiality permits large companies to spend substantial amounts of money without being required to disclose how such sums are spent. Substantial amounts which may be immaterial to large companies can be material for small companies and must be disclosed.

Management Advisory Services

The AICPA has encouraged accountants to perform a full range of non-accounting management advisory services. To guide accountants in providing management advisory services, the AICPA has issued a series of statements on management advisory services which may be obtained from the AICPA in booklet form. (See Appendix E, page 1041, for pertinent excerpts.)

Accounting firms that do not provide extensive management advisory services are encouraged to refer potential clients to accounting firms that do. The "Big Eight" average 11 percent of their gross revenues from performing such services, and they control the AICPA's committee which formulates AICPA policies on providing management advisory services.

Periodicals and Publications

The AICPA's Journal of Accountancy is one of the most prominent periodicals in the field of accounting. The CPA Letter, also published by the AICPA, provides current information on a wide variety of topics related to the interests of accountants.

The AICPA is a major publisher of technical accounting literature which is useful to practicing accountants and in continuing professional education courses. A booklet entitled "AICPA Publications and Self-Study Materials" describes the various publications, and may be obtained from the AICPA.

A more complete description of the periodicals published by the AICPA is included as exhibit four of the AICPA's response to this subcommittee. (See Appendix E, page 903.)

Uniform CPA Examination

The activities of the AICPA extend even to the preparation and grading of the examination which determines who shall be licensed to practice as a CPA. The Uniform CPA Examination prepared by the AICPA is used to test CPA applicants in all 50 States, as well as Guam, Puerto Rico, the Virgin Islands, and the District of Columbia. Thus, the AICPA touches the livelihoods of all accountants who are or seek to become CPAs, whether or not they belong to the AICPA.

The AICPA description of its role in developing and administering the Uniform CPA Examination appears in Appendix E, page 900.

National Association of State Boards of Accountancy

The National Association of State Boards of Accountancy (NASBA) is an organization which claims to represent the views and interests of the State boards of accountancy that regulate the accounting profession. This organization is separate from the AICPA, but the relationship between NASBA and the AICPA is so close that it provides another example of the AICPA's extensive influence over the regulation of accountants.

This subcommittee requested certain information from NASBA regarding its activities and financing. NASBA's response is included in Appendix F at page 1109.

The information submitted by NASBA portrays an extraordinary situation involving conflicts of interest in its financing. The manner in which it is organized also raises questions concerning the actual interests represented by NASBA. The apparent independence of state regulatory boards is diminished by their association with NASBA.

The various State boards of accountancy are created by State law to qualify accountants for practice and to regulate their conduct. State boards of accountancy have the sole legal authority to issue licenses to practice accounting, and to recommend revocation or suspension of such licenses where there is an infraction of applicable rules. Revocation or suspension of a license by a State board could prevent a CPA from acting as an independent auditor.

Because they exercise State authority in regulating the accounting profession, State boards of accountancy should be independent of undue influence by the accountants they regulate. Procedures to ensure independence of State boards are especially important since members of such boards are generally practicing accountants.

As part of its response, NASBA provided this subcommittee with its 1975 financial statements and a list of the contributors to its financial support. (See Appendix F, pages 1137 and 1145.) The financial statements show that voluntary contributions are a vital source of financing for NASBA. Excluding conference registration fees that are essentially spent on the meetings for which they are charged, NASBA depends on voluntary contributions for 60 to 70 percent of its annual revenues.

Approximately 80 percent of the voluntary contributions received each year for NASBA's support comes from the "Big Eight" accounting firms. The list of voluntary contributors submitted by NASBA in Appendix F at page 1145 shows that each of the "Big Eight" firms contributes $5,000 annually, for a total of $40,000.

This subcommittee has arranged the data on contributors submitted by NASBA to identify those contributing more than $1,000 annually. (See Appendix F, p. 1148.) The table developed by this subcommittee clearly demonstrates that the bulk of the funds used to finance NASBA's daily activities is contributed by the "Big Eight" and a few other large national accounting firms. About 85 percent of the $50,710 contributed to NASBA in 1975 came from the big national accounting firms.

The result of NASBA's dependence on the generosity of the big national accounting firms is to have the national organization which purports to represent State boards of accountancy largely financed by influential accounting firms that the State boards regulate. It is an obvious conflict of interest when regulated accountants finance the national organization of their State regulatory authorities. The public and those accountants who do not contribute to NASBA cannot be expected to have complete confidence in the independence and objectivity of the State boards of accountancy participating in NASBA under such conditions.

NASBA has recognized the impropriety of having its activities financed by gifts from regulated accountants and big accounting firms. While it has continued to accept such gifts on a "temporary" basis, NASBA commissioned a study which recommended selling its services as one method of raising revenues. In accordance with

that recommendation, NASBA's board of directors and the AICPA's board of directors agreed in October, 1975 that NASBA will be engaged by the AICPA on a fee basis to conduct an on-going audit of the uniform CPA examination process.

The AICPA prepares and grades the Uniform CPA Examination, which is used by all State boards of accountancy to evaluate the qualifications of applicants for CPA licenses. The new audit arrangement between NASBA and the AICPA will have the national organization of the State boards selling its services to the Nation's largest CPA lobbying organization. Although no audit fees have been accepted yet, NASBA expects that fees received from the AICPA will approximate $60,000 from the first year of auditing services.

AICPA members in public practice are regulated by State boards of accountancy, and the big national accounting firms control the AICPA. Apparently, NASBA believes that it is more proper to sell services to a lobbying organization for regulated accountants than to accept outright gifts from accounting firms. Both methods of raising revenues involve conflicts of interest between State regulators and regulated accountants.

There are serious legal and ethical questions concerning the propriety of State regulatory authorities joining together through NASBA to sell services to an organization of regulated accountants. NASBA's financial dependence upon regulated accountants is preserved under its audit arrangement with the AICPA. Reviewing the adequacy of examinations used to license CPAs should be part of the official duties of State boards of accountancy, especially when such examinations are prepared and graded by a professional lobbying organization whose members are regulated by the State boards. It is improper to have the AICPA pay NASBA for performing duties which are part of the official responsibilities of State boards.

NASBA's close relationship with the AICPA raises questions in other respects. The current president of NASBA is not even a member of a State board of accountancy. He is a former State board member, and a retired partner of one of the "Big Eight" accounting firms. The executive director of NASBA is a former AICPA employee. The AICPA furnishes free office space and other office services to NASBA at the AICPA's headquarters in New York City. In view of the AICPA's partisan lobbying activities on controversial accounting issues, NASBA's close association with the AICPA creates doubt about the independence of State boards of accountancy which participate in NASBA activities.

NASBA adopted new bylaws on 10 October, 1975 in an effort to change its organizational structure so that NASBA could more clearly represent the views of the State boards of accountancy. However, the new bylaws permit former members of State boards to become "associate" members of NASBA. The "associate" members have full rights to participate in the NASBA organization as officers, directors, and committee members, even though they have probably returned to the active practice of accounting and no longer have official State board responsibilities.

The only limitations on the participation of "associate" members in NASBA's organization are some requirements that a majority of its board of directors and certain important positions be filled with active

State board members. Those limitations are circumvented by the quorum provisions in the NASBA bylaws which make it possible for "associate" members to form a working majority. The bylaws do not guarantee that actions taken by NASBA represent solely the views of active State board members.

Its close relationship with NASBA is one means by which the AICPA is able to extend its influence to State boards of accountancy which regulate CPAs. Undoubtedly, many active State board members are also members of the AICPA, which is directly involved in influencing the activities of State boards of accountancy.

Professional Ethics Enforcement

All CPAs are required to adhere to a professional code of ethics when performing CPA services. Violations of ethical standards can lead to disciplinary actions by state licensing authorities and possible revocation of the license to practice as a CPA. As in every other significant area of accounting, the AICPA has taken the lead in developing a code of ethics to determine the manner in which accountants may practice.

Control over the determination of professional ethics is important because ethics guidelines define the types of services accountants may properly perform, and the relationships with clients that accountants may properly establish. For example, the AICPA-developed code of ethics permits accountants to perform non-accounting management advisory services without being deemed to have lost their professional independence from a client's management.

Standards of ethics also restrict advertising by accountants, and thus tend to restrict the development of competitive pricing and performance of accounting services.

The AICPA has prepared a description of its ethics enforcement apparatus and the results over the last five years as part of its response to this subcommittee. (See Appendix E, page 879.) Meaningful analysis of the success and quality of the AICPA's ethics enforcement program is difficult because of the many instances where the AICPA does not identify offenders.

A review of the ethics violators and their offenses reveals that there is no consistent relationship between the type of offense and the disciplinary action rendered by the AICPA. The restrictions on AICPA ethics enforcement activities have been previously discussed in the section of this study dealing with the organization of the AICPA. (See page 82.)

The ethics enforcement activities of the AICPA received some recent publicity when the AICPA found that former Secretary of Commerce Maurice H. Stans did not bring discredit to the accounting profession when he pleaded guilty to certain offenses relating to the Watergate scandal. Mr. Stans is a former president of the AICPA, a recipient of its highest honor award, and the former senior partner of Alexander Grant & Co., one of the 15 largest accounting firms. As a former AICPA president, Mr. Stans continues to hold a seat on the council of the AICPA.

A series of articles describing the reported efforts of Mr. Stans to obtain campaign contributions from the "Big Eight" accounting firms,

and the recent AICPA finding that cleared Mr. Stans of unethical conduct charges is included in Appendix E, at page 1050.

Another example of the AICPA's ethics enforcement program is its failure to take any action against partners of Peat, Marwick, Mitchell & Co. after that "Big Eight" firm was disciplined by the SEC. In Accounting Series Release 173, the SEC cited Peat, Marwick, Mitchell & Co. for improper auditing in five separate cases. (See Appendix C, page 736.) The AICPA made no attempt to discipline any of the individuals responsible for the improper acts by Peat, Marwick, Mitchell & Co., other than to terminate the AICPA membership of a few individuals who were convicted by the courts for their criminal conduct. The standard of ethics followed by the AICPA for partners of large national accounting firms appears to be that disciplinary action for ethics violations must be predicated upon a final verdict of guilty in a court of law.

Self-regulation of professional groups through codes of ethics theoretically supplants the need for legal standards of conduct by establishing higher standards of behavior than the law would impose. Such higher standards of conduct are thought necessary because a professional performs in a capacity which requires the utmost public confidence in his ability to serve the public interest. Public reliance upon the professional's reputation for making judgments on sensitive and important matters is based upon a belief that professional groups follow stringent procedures and demanding standards of conduct.

The Federal Government, business and the public are constantly encouraged by the AICPA to rely more and more on the expertise, dedication and professional reputation of CPAs. While promoting the value of professional CPA services, however, the AICPA is simultaneously seeking legislation, administrative rulings, and court decisions that will reduce the legal responsibilities of CPAs. In several areas, such as reporting illegal acts, establishing an "accountant-client" privilege, and limiting the damages which may be recovered from errant accountants, the AICPA is actually attempting to reduce the legal responsibilities of CPAs below what is expected from ordinary citizens. The contradictory stance of promoting professional privileges while opposing enforcement of associated professional responsibilities is prevalent in AICPA statements and activities.

The results of the AICPA's activities regarding professional ethics and acceptable practice standards are detrimental to the vast majority of CPAs who perform their services with competence, care and pride. By seeking lower standards for all accountants in order to defend the few who are negligent or incompetent, the AICPA contributes to the erosion of public confidence in the usefulness of accounting services.

Public Spokesman

As described previously (page 102), the AICPA spends substantial amounts to influence the Federal Government, the general public and special interest groups. The AICPA bylaws provide that the chairman of the board of directors and the full-time, salaried president are the official spokesmen for the AICPA. In addition, the AICPA committee structure continually develops and communicates policies and recommendations on specific topics.

The AICPA communicates its views in many ways, but the AICPA's annual report and speeches by the designated official spokesmen are two easily recognized methods of public communication. The joint statement of the chairman of the board and the president, at the front of the fiscal 1975 annual report, provides their views on the AICPA's activities during the year. They state that CPAs are undertaking many projects to cope with their changing environment, concluding, "It is this willingness to come to grips with public expectations that provides assurance of our profession's ability for self-renewal."

The president of the AICPA, in his 23 March, 1976 speech before the Los Angeles Chapter of the California Society of CPAs, described the private sector's failure to set satisfactory accounting and disclosure standards during the past 40 years. (See Appendix E, page 1055.) He concluded with a recommendation for a new approach. The fact that the AICPA has controlled the standard-setting mechanism for all those years and might therefore be responsible for the failure to achieve effective standards was not directly addressed by the AICPA's president. However, he recognized throughout his speech that an acceptable system of accounting standards has never been developed.

Even though the AICPA's role in that failure was described rather than discussed, and hope was expressed for the future, it is still remarkable that the president of the AICPA would make the following statement:

> In the private sector, business has gone through a series of damaging trends and events. In the 1960's there were the go-go managers who parlayed small companies into giant conglomerates through accounting manipulations that ultimately resulted in the bilking of hordes of small investors. These were accompanied by the spectacular collapse of a number of prominent companies whose securities were thought to be outstanding investments. The demise of such companies as Penn Central and Equity Funding has taken a toll in public confidence that may never be fully restored.

It is indicative of the AICPA's ability to note effects without mentioning causes that its president would admit the failures which have occurred without mentioning the dominant role played by the AICPA and the large accounting firms. The "accounting manipulations" used by go-go managers to bilk investors were permitted by large, respected accounting firms applying their concepts of generally accepted accounting principles. The AICPA's standard-setting apparatus was either unable or unwilling to prevent the use of misleading accounting procedures to create non-existent "earnings."

"Big Eight" firms were involved in both failures he mentioned. Through Accounting Series Release 173, the SEC has published a settlement agreement with Peat, Marwick, Mitchell & Co. which criticizes that firm's approval of misleading accounting principles by Penn Central's management. (See Appendix C, page 757.) The trustee in bankruptcy for Equity Funding has found that Haskins & Sells "must share significant responsibility for the persistence of the fraud at Equity Funding." (See Appendix C, page 721.)

The AICPA's president also noted his agreement with efforts to replace accounting based on known historical costs with accounting

based on estimated inflation values. He mentioned the possibility of using such inflation accounting for the purpose of computing business taxes. Adoption of inflation accounting would reduce the taxes paid by businesses.

Another concern expressed in his speech was the trend towards requiring greater disclosure by publicly-owned corporations:

> We are in the midst of a period of proliferating disclosure requirements and have reached a point where the footnotes in many cases overshadow the financial statements. There is widespread concern that an overload of disclosure may be counter-productive to understanding and that the benefits may not be worth the costs involved.

He then described the problems of disclosure with a series of questions:

> Where are we going with this insatiable demand for more and more information? Is it all really necessary? Who uses it and how and to what effect? Are the traditional rights to privacy going to be obliterated in the name of the public's need to know? Is the SEC's theory of differential disclosure valid or is it a rationalization of outmoded assumptions? Are we attempting to remove more risk from investment decisions than we can or should? If management and securities market fraud is our principal concern are there more effective ways than disclosure to deal with the problem?

The president of the AICPA recommended that one possible alternative would be to replace many of the factual disclosures by corporations with an analysis of the present condition and future prospects of a business: "It is not very satisfactory to give users of financial reports a lot of financial data and tell them to make their own analysis and interpretation," he said. "What they need is to be told what the financial data means in terms of the operations, financial condition and future prospects of the business."

In his view, the managements of businesses should be the ones to explain to investors and others how things are going. Auditors would be required to review and report on the reasonableness of management's analysis and interpretation. Until such a better reporting system is in effect, he concluded, "We shall carry our lighted lantern before us seeking fairness while standing waist deep in a swamp of disclosures at the height of the rainy season."

In view of the poor record by corporate managements and large accounting firms in reporting the many corporate abuses which have been revealed during the past few years, many persons might not agree with his alternative to meaningful factual disclosure. The creative manner in which factual data are currently presented in accordance with generally accepted accounting principles might cause a reluctance to rely solely on management analyses and interpretations without supporting factual data. The potential conflicts of interest in the proposed alternative would be too great for many to accept.

Despite the concern of the AICPA's president, the factual disclosures which have been required or proposed are minimal in comparison with the information which is necessary to evaluate properly the opera-

tions of a business. The abuses which have occurred have resulted from too little information as to the true state of affairs rather than too much information that confused investors and others. Proper disclosure may not reduce economic risks associated with investing, but it will reduce unnecessary investment risks resulting from misleading or omitted information.

Investors, government officials and the public are capable of making their own decisions regarding the content of information if it is disclosed in a meaningful and uniform manner. Problems have not resulted from the *quantity* of disclosure, but from the *quality* of disclosure.

Summary

Under the domination of the "Big Eight" accounting firms, the AICPA engages in extensive political, research, administrative, and educational activities which greatly influence accounting practices recognized by Federal and State governmental authorities. Some of the AICPA's activities are proper, while others are highly questionable. The AICPA has taken contradictory positions on several important issues.

The AICPA has developed prestige because of its size, resources, and the professional reputation of CPAs for objectivity, which has been accepted by the public and governmental authorities until recent years. Analysis of AICPA activities reveals that the organization primarily promotes the perceived interests of the large national accounting firms. Those interests are generally sympathetic to the management interests of large corporate clients which are the primary source of revenues for large accounting firms. Although there is a divergence of interests between large and small accounting firms based on their different styles of practice, no example has been found where the AICPA has promoted the interests of small accounting firms at the expense of the large national firms.

When evaluating the activities of the AICPA, the dominance of the "Big Eight" firms and the identities and affiliations of participating members must constantly be recognized. Their influence extends throughout society because of the importance of accounting practices to decision-making by business, government, unions, churches, pension funds and individuals in a complex economy where most information is received from third parties.

CHAPTER V. THE FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) AND RELATED ORGANIZATION

Introduction

The Financial Accounting Standards Board (FASB) is an organization established by certain influential business, accounting, and financial groups to determine and interpret accounting standards for use in preparing financial reports of businesses. Such standards and interpretations promulgated by the FASB are used for all types of financial reporting purposes. Their primary impact derives from the requirement that they be used in preparing corporate financial reports under the provisions of the Federal securities laws. Accurate and comprehensive information on the operations of publicly-owned corporations is essential to the proper determination of important economic and social questions.

The FASB and its private sponsors emphasize that it is an "independent" body when describing its purpose and activities, but the FASB is not independent of its sponsoring groups. The manner in which the FASB is organized and operated ensures that it will be responsive to the private interests of the groups that have created it. Continual use of the term "independent" in descriptions of the FASB does not alter the substance of its organization and financing which determine its purely private and dependent nature.

The notable factor which distinguishes the FASB from other well-financed private study groups is the unusual system which has evolved for setting accounting standards. A remarkable coalition of private interests, Federal agencies, and State regulatory authorities have agreed that accounting standards affecting the public interest should be set within the private sector. The result is that important public policies relating to accounting standards are determined by private groups with substantial vested interests in the outcome of the policy decisions.

It is not within the scope of this study to provide a detailed history of the manner in which the setting of accounting standards has evolved. That task has already been accomplished through the recent publication of a well-researched and perceptive book entitled "Corporate Financial Reporting—Public or Private Control?" by Professor Robert Chatov of the School of Management, State University of New York at Buffalo.[1] The purpose of this analysis is to describe the existing framework for setting financial accounting practices recognized by Federal agencies.

Some understanding of the reasons for creating the FASB is necessary, however, to evaluate properly its operation and functions. As part of its response to questions from this subcommittee, the FASB has provided its own description of its creation in the sections titled

[1] Chatov, Robert: Corporate Financial Reporting—Public or Private Control? The Free Press, A division of Macmillan Publishing Co., Inc.; 866 Third Avenue, New York, N.Y. 10022 (1975).

"Description of the Organization," and "Exhibit 4." (See Appendix H, pages 1224, and 1266.)

Evolution of Standard-Setting

Prior to the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934, accounting standards were developed and applied by businesses with the aid of the accounting profession. Because of abuses which occurred under that system, Congress enacted the Federal securities laws to protect the public and provide accurate information on publicly-owned corporations.

The Securities and Exchange Commission (SEC) was created by Congress to administer the Federal securities laws for the benefit of the public. It was given broad authority to determine accounting standards, procedures, and forms for publicly-owned corporations because sound accounting techniques are a necessary part of presenting financial information meaningfully. For various reasons relating to its status then as a new agency and its preoccupation with other matters, the five-member SEC decided by one vote to allow the development of accounting standards to remain in the private sector.

The congressional mandate expressed in the Federal securities laws was that financial and other information required to be disclosed by publicly-owned corporations should not be misleading. In an attempt to achieve that goal without involving the SEC in a comprehensive effort to develop and promulgate responsive accounting standards, the majority of SEC commissioners decided to require "substantial authoritative support" for accounting standards used in reporting financial information under the Federal securities laws. That policy was implemented by the SEC through issuance of Accounting Series Release No. 4 (ASR 4) in 1938. (See Appendix I, page 1432.)

ASR 4 stated that information filed with the SEC must be prepared in accordance with accounting standards for which there is substantial authoritative support, or else the information filed would be presumed to be misleading in violation of the Federal securities laws. Because of the legal remedies permitted against persons filing misleading information with the SEC, ASR 4 had the practical effect of forcing publicly-owned corporations to justify their accounting standards. Accountants also became involved in the justification process due to the legal liability incurred by independent accountants in certifying the validity of corporate financial information filed with the SEC.

The SEC also adopted a policy of footnote disclosure for cases where there is a difference of opinion between the SEC and a reporting corporation as to the proper accounting standards to be followed. The SEC decided that when there is substantial authoritative support for using alternative accounting methods to report the same business transaction, a publicly-owned corporation would be permitted to use the accounting method it prefers, while footnoting the effect of the method preferred by the SEC. This disclosure in lieu of correction policy means that the SEC does not insist on correction of financial statements which it believes are misleading, as long as accounting methods having substantial authoritative support are used in preparing the statements.

Because the SEC had decided—albeit by the tilt of a single vote—not to use its broad authority to set comprehensive and meaningful

accounting standards for publicly-owned corporations, the private sector was free to continue developing and applying accounting standards which served the purposes of corporate managements. The only significant factor remaining to protect the public interest was the mandate of the Federal securities laws that financial information should not be misleading.

The activities of the SEC regarding its accounting responsibilities are described further in the section of this study dealing specifically with the SEC. (See page 173.) Examples of misleading and abusive accounting practices which have been developed in the private sector under the accounting policies established by the SEC are also described in this study. (See page 188.)

In accordance with the SEC's accounting policies, managements of publicly-owned corporations and their auditors were able to develop and apply a body of alternative accounting standards which would be useful primarily in promoting their business objectives, rather than focusing on standards which would result in meaningful and uniform presentation of financial information to the public. The only condition was that accounting standards must be justified by substantial authoritative support, which would need to be developed within the private sector. The question was who in the private sector could provide suitable support for accounting standards designed mainly to promote corporate business interests.

The accounting profession filled the need for establishing a source of authority within the private sector to approve accounting standards. The AICPA, named the American Institute of Accountants at that time, designated a committee to provide an apparatus for giving consideration and formal approval to privately developed accounting standards. Formed in 1938, the Committee on Accounting Procedure had 22 members serving voluntarily on a part-time basis with a very small full-time research staff.

The Committee on Accounting Procedure was the first organized attempt to establish generally accepted accounting principles (GAAP) which would be acceptable to the SEC because of their "substantial authoritative support." This support would result from the AICPA's formalized approval process and the wide usage of AICPA-approved accounting standards by publicly-owned corporations that were clients of AICPA members. The Committee on Accounting Procedure issued its standards in the form of accounting research bulletins. A total of 51 such bulletins were issued during the 20-year life of the Committee on Accounting Procedure.

The Committee on Accounting Procedure was replaced in 1959 as the primary source of substantial authoritative support within the private sector. In its place, the AICPA established another committee of part-time volunteers to establish accounting standards in a manner which would satisfy the SEC's requirement for substantial authoritative support. The new AICPA committee was called the Accounting Principles Board. It was comprised of 18 members, including representation from small accounting firms and academic accountants as well as large firms, plus a small full-time staff.

The Accounting Principles Board issued 31 opinions on accounting standards before its demise in 1973. Because of its failure to set accounting standards for business combinations that would put a stop

to the accounting abuses being practiced in conglomerate acquisitions during the late 1960's, as well as its failure to resolve other accounting issues, the Accounting Principles Board was criticized by the SEC and the financial community for its inability to respond to important accounting problems. To counter such criticism, the AICPA conducted a special study on the establishment of accounting standards.

The AICPA study group was comprised of seven influential persons from the accounting and financial communities, and was commonly known as the Wheat study group after its chairman, former SEC Commissioner Francis M. Wheat. The Wheat study group was appointed in March, 1971 and issued its report, "Establishing Financial Accounting Standards," to the AICPA's board of directors in March, 1972. The board of directors approved the findings and recommendations of the Wheat study group, which were ultimately adopted by the council of the AICPA.

The Wheat study group recommended that accounting standards should be set within the private sector by a Financial Accounting Standards Board (FASB) with seven full-time, salaried members. The FASB would be advised by a Financial Accounting Standards Advisory Council (FASAC), and both the FASB and the FASAC would be appointed and financed by a Financial Accounting Foundation (FAF). The present system for setting accounting standards within the private sector is a direct result of the Wheat study group's recommendations.

The current FASB structure for setting accounting standards is significantly different from previous AICPA efforts in several respects. The first is that the FASB is not a committee of the AICPA. Although it is controlled by the AICPA, it is organized and functions separately from the AICPA.

Second, the FASB structure provides for participation in the setting of accounting standards by other influential private interest groups. Members of the FASB are not required to belong to the AICPA, as were members of previous standard-setting bodies.

The third difference is that AICPA members are now required to use accounting standards established by AICPA-designated bodies, rather than looking to them only for guidance. Rule 203 of the AICPA's code of ethics designates the FASB as the body for setting accounting standards which are binding on members. To the extent that they have not been superseded by action of the FASB, standards promulgated by the AICPA's Committee on Accounting Procedure and Accounting Principles Board are also binding on AICPA members.

Fourth, the FASB has only seven members. The small number is intended to facilitate discussion and decision-making. The FASB is also full-time, well-financed, and has a supporting staff of approximately 80 persons. Organized procedures for FASB decision-making permit exposure drafts, open comment, and public hearings. Finally—and most importantly—the FASB has received special recognition by the SEC through Accounting Series Release 150, as will be described subsequently.

The FASB has provided abundant information on its organization and activities through its annual reports and its response to questions from this subcommittee. (See Appendix H, page 1219). While much

of that information is described and referenced within the text of this study, interested persons will find additional data and information on FASB activities in the appendix materials. The FASB has also prepared a brief description for this subcommittee of the essential facts and relationships among the three units of the FASB organizational structure. (See Appendix H, page 1224.)

The SEC's "Substantial Authoritative Support" Test

The "substantial authoritative support" test adopted by the SEC to determine whether accounting standards are misleading is vague. There is no precise definition as to what constitutes "substantial authoritative support." Although authoritative support may come from government regulations, scholarly writings, and other such sources, the primary method has been through the establishment of generally accepted accounting principles (GAAP), which depends on acceptance as the source of authoritative support. Obviously, problems were sure to result from a system which measures the quality of accounting standards by the degree of their general acceptance.

Some severe problems have indeed resulted from the reliance on GAAP to provide accounting standards which will ensure that financial statements are not misleading. The two major problems are the variety of acceptable accounting alternatives which have evolved to account for the same business transaction, and the failure of the general acceptance criterion to select the accounting standards which provide the most meaningful information to the public.

Concerning the first problem, Professor Abraham Briloff has described the variety of acceptable accounting alternatives in his recent book entitled "More Debits Than Credits".[1] Professor Briloff produced the following table showing the number of different accounting methods available for use in reporting common business transactions:

Transaction:	*Number of Alternatives*
When revenue generally recognized	3
When revenue recognized for long-term contractors	2
Accounting for unfunded pension cost	2
Accounting for funded pension cost	3
Charging of real and personal property taxes to income	8
Treatment of tax versus financial accounting divergencies	3
Methods of depreciation	4
Inventory methods	5
Accounting for discounts	2
Fixed asset acquisition	4
Fixed asset construction	3
Development costs in extractive industries, et cetera	3

Professor Briloff based his table on a study of acceptable alternative accounting practices which was sponsored by the AICPA. In all, the study listed 31 separate kinds of business transactions with an aggregate of 80 different accounting alternatives. Although the various accounting methods may lead to financial statements showing completely different results from the same set of business transactions, publicly-owned corporations are free to choose any method they desire from the catalogue of GAAP.

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[1] Briloff, Abraham J., "More Debits Than Credits," Harper & Row, New York, N.Y. (1976), page 7.

The second major problem—the failure of the general acceptance criterion to select accounting standards that are the most appropriate for presenting meaningful financial information to the public—begins with the difficulty of identifying the parties among whom GAAP are generally accepted. For the most part, they are the large national accounting firms which control the AICPA's standard-setting apparatus, and whose major clients are the publicly-owned corporations that are affected by GAAP.

Accounting practices that are readily accepted by corporate managements and their auditors are not necessarily those acceptable to persons who must rely completely on the information presented in financial statements to evaluate corporate activities. Investors, government authorities, the public, and even creditors traditionally have not had the opportunity to "generally accept" accounting standards until they appear in corporate financial statements under the designation of GAAP.

General acceptance of accounting standards usually means the lowest common denominator acceptable to everyone involved in the process of acceptance. Unfortunately, the lowest common denominator rarely means the most meaningful choice because parties with vested interests will object to accounting standards which might clearly show unfavorable operations, mistakes and improprieties. Accounting standards most beneficial in providing accurate information to the public on corporate activities are also bound to encounter stiff opposition from those who would be forced to give up the ability to manipulate information to their advantage.

Organizational Structure

Four influential accounting and business groups have joined with the AICPA in sponsoring the FASB.[1] As sponsors, they are permitted to nominate certain of their members for election to positions of power within the FASB structure. They are also pledged to help finance its operations.

In addition to the AICPA, the four other groups sponsoring the FASB are:

The American Accounting Association,
The Financial Analysts Federation,
The Financial Executives Institute, and
The National Association of Accountants.

A description of the memberships and activities of these groups is contained in Chapter VII (see p. 158). This subcommittee also requested information from each of the groups sponsoring the FASB. The responses are contained in Appendix G, p. 1149.

The FASB is structured so that it is controlled by the AICPA, but the other four sponsoring groups are permitted limited participation in the FASB decision-making process. It was intended that the participation of other private groups with a strong self-interest in the determination of accounting standards would broaden support for

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[1] The Securities Industry Association was added as the sixth sponsor of the FASB on 1 October, 1976. Although added as a sponsoring group too late to be included in this study, the Securities Industry Association reportedly represents the interests of more than 800 investment banking firms. Its addition as an FASB sponsor does not significantly affect the findings of this study.

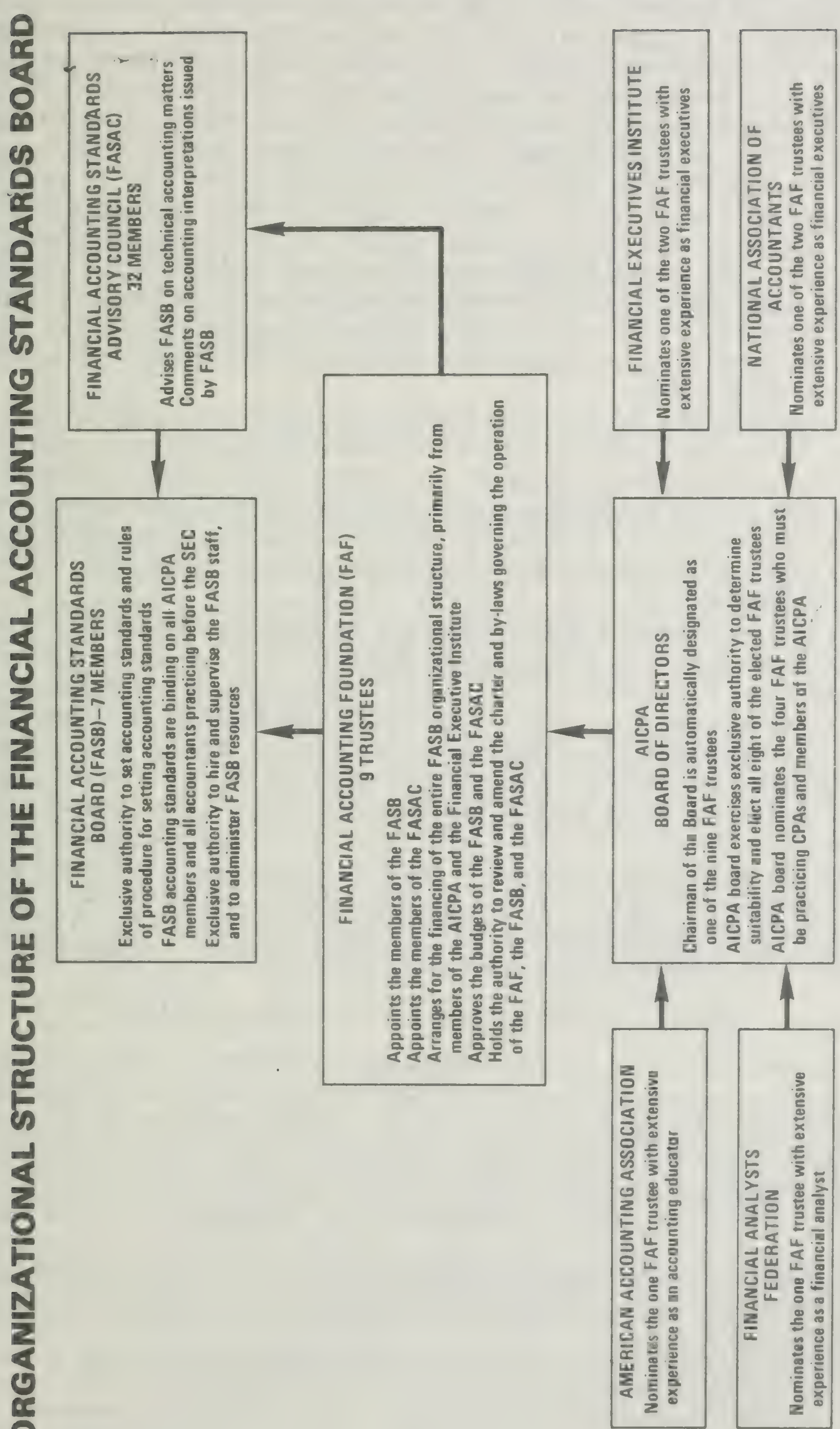
FASB pronouncements. Allowing participation by other private interest groups serves the dual purpose of thwarting charges that the FASB is merely a committee of the AICPA, while also removing from the list of potential FASB critics four of the most influential groups within the private sector in regard to accounting matters.

The procedural rules governing the establishment of accounting standards by the FASB provide an opportunity for critical comment by interested parties and the public before final adoption of standards. Exposure drafts of proposed accounting standards are circulated for comment and public hearings are usually held. These forms of public participation, however, do not alter the fact that the actual decisions on accounting standards are made behind closed doors by private parties with a vested interest in the outcome.

The three units comprising the FASB organization are:

The Financial Accounting Foundation (FAF),
The Financial Accounting Standards Board (FASB), and
The Financial Accounting Standards Advisory Council (FASAC).

CHART 3


ORGANIZATIONAL STRUCTURE OF THE FINANCIAL ACCOUNTING STANDARDS BOARD
FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL (FASAC) 32 MEMBERS
Advises FASB on technical accounting matters
Comments on accounting interpretations issued by FASB
FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)—7 MEMBERS
Exclusive authority to set accounting standards and rules of procedure for setting accounting standards
FASB accounting standards are binding on all AICPA members and all accountants practicing before the SEC
Exclusive authority to hire and supervise the FASB staff, and to administer FASB resources
FINANCIAL ACCOUNTING FOUNDATION (FAF) 9 TRUSTEES
Appoints the members of the FASB
Appoints the members of the FASAC
Arranges for the financing of the entire FASB organizational structure, primarily from members of the AICPA and the Financial Executive Institute
Approves the budgets of the FASB and the FASAC
Holds the authority to review and amend the charter and by-laws governing the operation of the FAF, the FASB, and the FASAC
FINANCIAL EXECUTIVES INSTITUTE
Nominates one of the two FAF trustees with extensive experience as financial executives
NATIONAL ASSOCIATION OF ACCOUNTANTS
Nominates one of the two FAF trustees with extensive experience as financial executives
AICPA BOARD OF DIRECTORS
Chairman of the Board is automatically designated as one of the nine FAF trustees
AICPA board exercises exclusive authority to determine suitability and elect all eight of the elected FAF trustees
AICPA board nominates the four FAF trustees who must be practicing CPAs and members of the AICPA
AMERICAN ACCOUNTING ASSOCIATION
Nominates the one FAF trustee with extensive experience as an accounting educator
FINANCIAL ANALYSTS FEDERATION
Nominates the one FAF trustee with extensive experience as a financial analyst

Although administrative authority and funding passes from one FASB organizational unit to the next, the private interest groups in control of each organizational unit remain the same. In many cases, the same influential individuals appear as leaders of the sponsoring groups and as members of the organizational units involved in the FASB structure. Thus, the real identity of the parties in control of the FASB is the same as that of the private sponsoring groups.

The power to select the members of the FAF, the FASB, and the FASAC ultimately resides with the board of directors of the AICPA, although the other four sponsoring groups have certain rights to nominate some candidates. The money to operate the FASB organization is contributed by all five sponsoring groups, as well as some other private groups.[1] The vast majority of the money for the FASB, however, is contributed by the members of the AICPA and the Financial Executives Institute.

To separate the FASB from the sponsoring groups on an organizational basis, the FASB structure was formed as a non-profit corporation. Its structure as a non-profit corporation also serves to make contributions to the FASB tax-deductible for Federal income tax purposes. That means the Federal Government is partially subsidizing the setting of accounting standards by private groups with vested interests in the outcome.

As will be described in the following sections, the flow of funds and power from the sponsoring groups through the FAF to the FASB is a separation in appearance only. The relationship between the sponsoring groups and the FASB is similar to that between the companies in a joint venture. The organizational units are legally separate and the transactions between them are recorded as if they were at arms-length. But the same parties are in control of all the organizations involved in the venture. The FASB can accurately be described as the operating subsidiary of the joint venture in setting accounting standards undertaken and controlled by the AICPA, the Financial Executives Institute, the National Association of Accountants, the American Accounting Association, and the Financial Analysts Federation.

Financial Accounting Foundation (FAF)

The Financial Accounting Foundation (FAF) is the non-profit corporation organized by the AICPA in conjunction with the other four sponsoring groups to operate the FASB. Chart 3 on page 137 shows that the FAF is the first entity separating the AICPA and the other sponsoring groups from direct participation as organizations in the setting of accounting standards. This organizational separation differentiates the FAF from previous AICPA efforts to set accounting standards, and is the basis for the claim that the FASB is "independent." Separate organizations, however, do not mean separation from

[1] Contributions in excess of $1,000 to FAF/FASB in 1974 and 1975 from other sources were:

Name	Amount 1975	Amount 1974
New York Stock Exchange	$50,000	$50,000
Liberty Fund	2,000	
Stanford University		1,000

the control exercised by the AICPA and the other sponsoring groups.

The certificate of incorporation and bylaws of the FAF and its operating units, the FASB and the FASAC, are included in Appendix H at page 1367. They detail the careful manner by which power is shared among the five private groups sponsoring the FAF. But the ultimate authority to control the FAF—and consequently the FASB—is retained by the AICPA's board of directors. This analysis will focus on the provisions of the certificate of incorporation and bylaws which serve to guarantee that the FAF will reflect the views of its sponsors.

The FAF exercises certain basic corporate powers to obtain the necessary funds for operations and to select the members of the FASB and the FASAC. As described by the FASB in Appendix H at page 1224, the principal duties of the FAF are:

1. To appoint the members of the Financial Accounting Standards Board.
2. To appoint the members of the Financial Accounting Standards Advisory Council.
3. To arrange for the financing of the organization.
4. To prepare and administer the budget of the Financial Accounting Foundation.
5. To approve the annual budget of the FASB and the FASAC, as prepared and presented by the chairman of the FASB.
6. To review periodically the bylaws of the FAF, and the basic structure for establishing and improving standards of financial accounting and reporting.

The FAF corporate charter provides that the governing body of the FAF will be the board of trustees which shall consist of nine members. The board of trustees is authorized to exercise all powers of the FAF except those that are reserved to the FASB and the FASAC in the charter.

The FAF charter is very specific as to who shall be eligible to serve on the board of trustees. The chairman of the board of the AICPA is automatically an FAF trustee for the duration of his term, which is one year. The remaining eight trustees are elected to three-year terms at staggered intervals. Four of the eight elected trustees are to be CPAs in public practice at the time of their election; two trustees are to be financial executives; one trustee is to be a financial analyst; and one trustee is to be an accounting educator.

The mandate of the charter as to the qualifications and proportionate representation of the trustees is amplified in the FAF bylaws. Not just any CPA, financial executive, financial analyst, or accounting educator may apply for membership on the FAF board of trustees.

As provided in the FAF bylaws, the four trustees who are to be practicing CPAs are also required to be AICPA members. That requirement is probably not necessary since the AICPA's board of directors is designated to nominate those four trustees. The FAF bylaws also require that the two trustees who are to be financial executives shall be nominated, one each, by the Financial Executives Institute and the National Association of Accountants. The American Accounting Association is designated to nominate the FAF trustee who is an accounting educator, and the bylaws state that the Financial

Analysts Federation shall nominate the trustee who is a financial analyst.

Thus, all nine FAF trustees are from the five sponsoring groups, except in the unlikely event that one of the sponsors should nominate someone from outside its own membership.

This exclusionary nominating process is written into the bylaws to ensure that FAF trustees represent the views of the sponsoring groups, and that each sponsor has proportionate representation on the board of trustees.

The charter enables the AICPA to control the FAF since five of the nine trustees are directly assigned to the AICPA. Each of the other four sponsoring groups is permitted one trustee, however, most of those trustees also have membership in the AICPA. The votes of six of the nine trustees are necessary to act for the FAF, and the AICPA needs only one vote from its members belonging to the other sponsoring groups to have a six-vote majority on the board of trustees.

The charter has yet another provision which guarantees that the AICPA will completely control the FAF. The charter specifically directs that the AICPA's board of directors shall *ex officio* constitute the voting membership of the FAF as a non-profit corporation. Thus, the exclusive power to elect the entire FAF board of trustees is automatically given to the AICPA's board of directors.

A description of the composition of the AICPA's board of directors and the identities of the groups that control it are included in the previous chapters of this study dealing with the organization of the AICPA and the influence of the "Big Eight" accounting firms on its activities. In summary, all of the significant AICPA committees, including the board of directors, are controlled by the large national accounting firms.

As the solely designated corporate electors of the FAF, the AICPA's board of directors is in the position of both nominating and electing the four FAF trustees who are practicing CPAs. In addition, the chairman of the AICPA's board of directors is automatically designated as an FAF trustee. Control over the selection of trustees by the other four sponsoring groups is exercised by the requirement that all trustees must be elected by the AICPA's board of directors, who are exclusively designated as "electors" in the FAF bylaws.

Because the other four sponsoring groups may nominate, but not actually select, their choices as trustees, the bylaws provide that each sponsoring group shall submit a list of three or more nominees to the AICPA's Board of Directors. Although there is a requirement that "the Electors shall not unreasonably withhold the election of a trustee from among the nominees submitted by a nominating organization," the FAF bylaws nevertheless state that "the Electors shall be the sole determiners of whether a nominee is suitable for election as a trustee." If another sponsoring group should attempt to nominate persons who are not acceptable as trustees to the AICPA's board of directors, and consultations do not resolve the differences, the board of directors, under the bylaws, may simply elect someone who in its judgment is acceptable and meets the experience qualifications described in the bylaws.

The two most important functions performed by the FAF's board of trustees are the appointment of FASB and FASAC members, and

the financing and budget approval of the FASB and FASAC operations. Consequently, the FAF charter restricts the ability of the trustees to influence directly the activities of the FASB and the FASAC because such direct influence could appear to affect the "independence" of the FASB.

There are three basic restrictions placed on the FAF board of trustees. The first is that no trustee may simultaneously serve as a member of the FASB or the FASAC. This provision prevents the obvious conflict of having members of the board of trustees appoint themselves to the FASB or the FASAC, and thus become involved in the actual setting of accounting standards.

The second restriction is that the board of trustees may not condition its approval of the FASB's budget on the agreement that the FASB shall undertake or not undertake any particular project relating to its function of setting accounting standards. This restriction prevents the trustees from withholding financing to influence the actions of the FASB.

The third restriction narrows the reasons for which the FAF board of trustees may remove a member of the FASB from office. A two-thirds majority vote of the trustees is necessary to remove an FASB member. The bylaws state that a member may be removed only for disability lasting more than six months, for "malfeasance or alleged malfeasance in office," or for other cause deemed by the trustees as "reasonably evidencing conduct detrimental to the purposes or repute of the FASB."

This last condition of removal is apparently broad enough to permit removal for anything that might offend the sensitivities of the FAF trustees. Conceivably, espousing the view that the FASB is incapable of setting accounting standards in the public interest, or that the Federal Government should use its authority in this area of public policy, could well be interpreted by the FAF trustees as "reasonably evidencing conduct detrimental to the purposes or repute of the FASB." Thus, FASB members are not truly independent once they are appointed; it is always possible that they may be removed if they do not continue to meet the expectations of the trustees.

The same conditions of removal also apply to removal of FAF trustees. The bylaws provide that a two-thirds majority vote of the AICPA's board of directors is necessary to remove a trustee from office. The grounds for removal include disability, malfeasance in office, and the broad consideration of conduct "detrimental to the purposes or repute of the FAF or the FASB." In the same manner by which the FAF trustees may continue to control the conduct of FASB members, the AICPA's board of directors may continue its control over the conduct of the FAF trustees.

Although expressed in the FAF bylaws as a restriction on removal, the detrimental conduct provision reads more like an excuse for removal. An additional factor weakening the restrictions on removal of trustees and FASB members is the extensive amount of discretion permitted the AICPA's board of directors and the FAF trustees in performing their duties. They are permitted, under the FAF charter and bylaws, broad authority to modify decisions regarding the selection and removal of officials and in performing other functions.

Furthermore, there are no legal remedies against the AICPA's board of directors or anyone involved in the FAF organization, even

if they decide to violate openly the provisions of the charter and bylaws. They are private organizations, and the chairman of the FASB has pointed out that the Federal courts have declined to get involved with the procedures of private organizations that are engaged in setting accounting standards. (See "The Politics of Establishing Accounting Standards" in Appendix H, at page 1398.) The careful manner of selecting FAF trustees and FASB members makes it unlikely that any of them would need to be removed for disagreement with the AICPA's board of directors.

The FAF charter also grants to the board of trustees the exclusive power to amend the certificate of incorporation and bylaws of the FAF. The vote of eight trustees is necessary to amend either the certificate of incorporation or the bylaws.

As shown by Chart 3 on page 137, the FAF is a conduit to the FASB for the AICPA and the other four sponsoring groups. Operating funds and the authority to set accounting standards within the private sector pass from the AICPA and the other sponsors through the FAF to the FASB.

Therefore, the FAF is organizationally separate from the sponsoring groups and functionally separate from the FASB. It is necessary to the scheme of the FASB, as the "independent" standard-setting body within the private sector, that there be an appearance of independence from the AICPA and the other sponsoring groups. That requires an intermediate level of organization between the FASB and its sponsors, and the FAF supposedly fills this need.

Without the FAF, the AICPA and the other sponsors would be forced to appoint the members of the FASB and finance its operations directly. The FASB would then obviously appear as nothing more than a joint committee of the sponsoring groups, and could not be referred to as "independent."

The assertion that the FASB is "independent" is important because that is the primary factor which is supposed to boost its credibility beyond that of the previous standard-setting bodies within the private sector.

Repeated transfer of funds and authority among organizational units cannot separate them if each one is in effect controlled by the same private interest groups. As has been shown, the FAF charter and bylaws are carefully worded so that the AICPA will control the FAF, and the other four FASB sponsors will have a minority influence on FAF activities. Other than the fact that it has its own certificate of incorporation and bylaws, the FAF is really not much different from other AICPA committees which have had outsiders as members. The AICPA maintains ultimate control, and the members selected to serve on the FAF tend to closely reflect the views of the AICPA's leadership.

The following section will illustrate how the AICPA's control over the FAF is extended to the FASB by the language of the charter and bylaws. That is the next step in the elaborate system by which the AICPA's board of directors exercises control over the setting of accounting standards under the guise of the "independent" FASB.

Financial Accounting Standards Board (FASB)

The FASB conducts the actual research on accounting standards, considers the views of the five sponsoring groups and others which

are submitted in response to proposals, and makes the final decisions as to how financial information will be presented to the public.

Before considering the composition of the FASB, the extent of its resources should be recognized. The 1975 annual report of the FASB shows that it had revenues of almost $5.3 million and expenditures of over $3.5 million, with a balance of $4.4 million left in its general fund. (See Appendix H, page 1363.) It has a full-time staff of approximately 80 persons which is complemented by part-time volunteers from the major accounting firms and big businesses who work on specific projects. All of these resources are applied to the task of setting financial accounting standards according to the detailed procedures described in the FAF bylaws and the FASB rules of procedure.

The FASB is comprised of seven full-time members who are appointed to serve staggered five-year terms by the FAF board of trustees. No more than two consecutive five-year terms may be served by any individual member.

The FAF bylaws require that four of the seven FASB members be CPAs who are principally experienced as public practitioners. The three remaining FASB members need not be CPAs, but are required to be well-versed in the problems of financial reporting. The FAF board of trustees appoints one member to serve at its pleasure as chairman of the FASB.

To date, all of the members appointed to the FASB have been members of one or more of the five sponsoring groups. (See Appendix H, page 1263.) Four members, including the chairman, were formerly with large accounting firms. The other three FASB members include a former accounting educator, a former corporate financial executive, and a former chief accountant of the Federal Power Commission. Although the bylaws permit appointment of as many as three FASB members who are not CPAs, only CPAs have been appointed so far.

FASB members are well-compensated and are expected to sever all financial connections which they believe might affect the objectivity of their decisions. Each of the six regular members of the FASB receives an annual salary of $115,000, and the chairman is paid $150,000 annually. In addition, FASB members receive generous retirement, life insurance, and health insurance benefits. (See Appendix H, pages 1228 and 1229.)

The theory behind substantial compensation for members is that such amounts are necessary to attract competent individuals to serve on the FASB, and to ensure that members are financially independent from their previous business and professional affiliations. The large salaries paid to members do not guarantee their independence from the five private interest groups and their members which sponsor the FASB. Most of the money for operating the FASB, including the salaries and benefits of its seven members, comes directly from the contributions of the sponsoring groups and their influential members. The FASB and its members are thus dependent on the continued voluntary financial support of the five sponsoring groups, especially the AICPA and the Financial Executives Institute, which are the largest sources of contributions.

Continued voluntary financial support for the FASB can reasonably be expected to be related to the acceptance of FASB pronouncements by its sponsoring groups. If it should act against their collective desires, then financing for the FASB might not be forth-

coming. In that situation, its members would stand to lose their generous compensation and benefits. The greater the amount of compensation and benefits, the greater the amount of personal financial loss which would be sustained by members of the FASB. Thus, the high level of compensation paid to members of the FASB can be viewed as actually increasing their dependence on the private interest groups which are its sponsors.

The manner in which FASB members are selected ensures that they will be compatible with the interests of the sponsoring groups. The FAF board of trustees, which is itself carefully chosen in a manner to reflect the views of the AICPA's board of directors and the other four sponsoring groups, appoints the members of the FASB according to the formula set forth in the FAF bylaws. As the chosen agent of the AICPA and the other sponsors, the board of trustees appoints persons who represent the respective interests of the sponsors to the FASB.

All authority to set financial accounting standards and the procedures for reaching decisions on such standards is delegated to the FASB by the FAF charter and bylaws. The FASB makes the actual decisions on which accounting standards will govern the presentation of financial information to investors, creditors, governmental authorities and the public. An affirmative vote by five of the seven members is necessary to issue authoritative pronouncements on accounting standards.

As part of its claim to independent operation in the public interest, the FASB has developed rules of procedure for promulgating accounting standards. The procedural rules generally permit an organized opportunity for critical comment on FASB proposals before they are finally adopted as standards. Even though there is theoretically an opportunity for the public to comment on FASB proposals, limited public awareness of the FASB and its impact on important economic and social issues effectively preclude active participation by diverse segments of society in the standard-setting process.

Under the FAF bylaws, the chairman of the FASB is granted a great deal of influence over its activities because of his authority to schedule projects, hire the staff, and control the resources of the FASB. The extent of the chairman's influence is described in the bylaws:

> Section 11. *Chairman of the Financial Accounting Standards Board*—
>
> The Trustees shall appoint, to serve at their pleasure, a member of the FASB as its Chairman and may also appoint one or more other members as Vice Chairmen to exercise the powers and to carry out the duties of the Chairman in his absence or disability. The Chairman of the FASB shall serve *ex officio* as Chairman of the Council (FASAC). The Chairman shall be the principal officer of the FASB and the Council, and shall preside at their meetings.
>
> The Chairman shall prepare the agenda of projects of the FASB and assign priorities thereto for submission to the FASB for approval. He shall prepare the annual budget of the FASB and the Council following consultation with other members of the FASB, and submit such budget to the Trustees for their approval. He shall also prepare an annual report with respect

> to the activities of the FASB and the Council and shall submit such report to the Trustees, the AICPA and the nominating organizations, which report shall constitute a portion of the public record of the FASB.
>
> He shall have authority to hire, retain and contract with staff members to serve the FASB or the Council, to fix their duties and the amount of their salaries and other compensation and to appoint and contract with any other persons or organizations with respect to research and other services to be performed by them as consultants or independent contractors. The Chairman also shall have authority to establish and appoint persons to task forces (who may but need not be members of the FASB or the Council) with the advice of other members of the FASB and, as he may deem appropriate, after consultation with members of the Council, and he may delegate or assign particular functions or duties to other members of the FASB, the staff of the FASB or the Council or others as he may determine.
>
> The Chairman shall be responsible for establishing operating and administrative procedures for task forces and the staffs of the FASB and the Council, and for implementing and directing the broad operating processes of the FASB and the Council.
>
> He may appoint an administrative director and a research director and shall designate a member of the staff of the FASB to serve as secretary and to keep a record of its proceedings. Staff members, and members of task forces, and other persons and groups employed, hired or otherwise retained or appointed by or at the direction of the Chairman, shall serve at the pleasure of the Chairman or as otherwise provided in contracts made by or at his direction.

One of the most important responsibilities assigned to the chairman of the FASB is the authority to appoint task forces for specific projects. Much of the work in researching and developing FASB positions on particular accounting issues is performed by such task forces.

The direction taken by the FASB on various accounting issues can be profoundly influenced by the composition of the task forces involved in developing the issues. The influence of the task forces is enhanced because FASB members and staff are included as members and work closely with the outside members of the task forces.

The FASB has provided this subcommittee with a list of task force members and their principal business affiliations, as well as a list of consultants hired by the FASB. (See Appendix H, pages 1303 and 1301.) This subcommittee has rearranged the members of the task forces according to the principal business affiliations of the members serving on each task force. (See Appendix H, page 1423.) The subcommittee's compilation of the various interests represented on the task forces shows a preponderance of large accounting firms, corporate clients of "Big Eight" accounting firms, contributors to the FASB, large investment firms, and big banks.

Many of the task force members have significant vested interests in the FASB's decisions on the accounting issues being considered by a particular task force. Of the 179 task force members listed by the FASB, three represent the Federal Government, one represents a labor union, and the rest represent private business interests or are academics. There are no representatives from small businesses, consumer organizations or public interest groups.

An example of FASB task force membership selection is the extractive industries task force which is developing the FASB proposals on accounting standards to be used by oil, gas, and mining companies. Accounting methods used by the extractive industries have been controversial and the subject of recent congressional action. This subcommittee has compiled a list showing 19 identifiable interests serving on the extractive industries task force. (See Appendix H, page 1425.) Of those 19 interests, 17 are easily identified as having an actual or potential financial interest in the outcome of the controversy regarding accounting methods used by extractive industries. Among them are two mining companies, six oil companies, five of the "Big Eight" accounting firms with major corporate clients in the extractive industries, three large investment firms, and one of the Nation's largest banks with substantial financial interests in the extractive industries.

The views of the five private interest groups sponsoring the FASB are reflected in both the decision-making and working levels of the FASB. Through the FAF, the FASB is dependent on its sponsors for the bulk of its financial support, and for the appointment, reappointment, and continuing approval of its well-compensated members. Without the substantial voluntary financial and organizational support of the five sponsoring groups, the FASB would not be able to survive.

The AICPA and the other four sponsors have ensured that the FASB will operate in their interests by creating an organizational system which selects acceptable persons to serve on the FAF and the FASB, and by making the FASB financially dependent on the sponsoring groups. As will be shown subsequently, the FASB has performed in accordance with the interests expressed by the AICPA, the major accounting firms, and the big corporations primarily affected by the accounting standards issued by the FASB. Despite its elaborate organization and procedures, the FASB is not independent, and cannot be realistically expected to ever become independent from the AICPA and the other four private interest groups which sponsor it.

Financial Accounting Standards Advisory Council (FASAC)

The Financial Accounting Standards Advisory Council (FASAC) is the third organizational unit in the FAF–FASB structure. Unlike them, however, the FASAC does not play a substantial role in the process by which funds and the authority to set accounting standards within the private sector flow from the AICPA and the other sponsoring groups in an effort to create an appearance of "independence." Instead, the FASAC advises the FASB and provides an organized apparatus to give credence to the FASB's claim that it seeks divergent views on accounting issues.

According to the FAF bylaws, the FASAC is to be comprised of at least 20 persons who, in the judgment of the FAF board of trustees, are knowledgeable about the problems and impact of financial reporting. The board of trustees appoints members of the FASAC for one-year terms, with a normal maximum of four consecutive terms. The FASAC members are required to "broadly represent varied professional and occupational backgrounds with no profession or occupation predominating."

The chairman of the FASB also heads the FASAC. Upon his request, members of the FASAC consult with the chairman concerning the FASB's agenda of projects, the priority assigned to such projects, matters likely to require the attention of the FASB, and the selection of FASB task forces. Upon request of the chairman, the FASAC members also provide written comments on proposed FASB interpretations of existing accounting standards. The FAF bylaws require that the FASAC meet as a body at least quarterly; its members are paid only for their expenses. The bylaws provide that the FASAC shall not vote as a body or issue public communications.

The FASAC is only one source from which the FASB receives comments on its activities, but it is the one source of advice and comment which is organized by the five sponsoring groups as part of the FASB operation. The FASAC is important in helping to create an appearance that the FASB is "independent" and has broad-based support.

Currently, 32 members serve on the FASAC. A list of its members and their primary business affiliations is contained in Appendix H, at page 1395. Of the 32 members, two are from the Federal Government, two are academics active in the groups sponsoring the FASB, and one is a retired chief accountant of the SEC who subsequently worked as a consultant for the AICPA. The other members of the FASAC are drawn from the same group of big accounting firms, big investment firms, big law firms, and big corporations which dominate every facet of FASB activity, and which constitute the primary memberships of the five private interest groups sponsoring the FASB. Thus, the interests of other groups that are profoundly affected by FASB pronouncements—such as small investors, small businessmen, consumers, and public interest groups—are not represented even on the FASAC, which only advises the FASB.

Although the determination of financial accounting standards directly and indirectly affects all levels of society, the FAF, the FASB and the FASAC are structured so that only the narrow vested interests of the influential members of the AICPA, the Financial Executives Institute, and the other sponsoring groups are actively represented in the standard-setting process. As presently constituted, the FASAC is just another device by which the AICPA and the other sponsoring groups are attempting to create an appearance of "independence" in the setting of accounting standards by appointing their own influential members to separate organizations which are controlled and supported by the five sponsors.

Policies to Prevent Conflicts of Interest on the FASB*

As part of the attempt to have the FASB accepted as an "independent" body operating within the private sector, the AICPA incorpor-

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*The following policies regarding conflicts of interest apply only to members and staff of the FASB. This subcommittee also requested a description of any restrictions on conflicts of interest by members of the FAF board of trustees and the AICPA's board of directors. That request was prompted by the very important and influential roles played by those persons in selecting the members of the FASB and financing its operations.

The FASB responded that the FAF bylaws and the trustees' policies are so successful in assuring that the FASB is independent and free from outside pressures that, apart from practical considerations, there is no need to impose any restrictions on the AICPA's board of directors or the FAF board of trustees. In view of its advisory role, members of the FASAC are not subject to any restrictions regarding conflicts of interest. (See Appendix H, page 1292.

ators of the FAF provided in the bylaws that the board of trustees should develop policies which, in the judgment of the trustees, would prevent conflicts of interest concerning the seven members of the FASB and three senior staff administrators. Also, the chairman of the FASB, who exercises complete authority over its staff, has issued general policies covering all staff members which are similar in tone to the conflict of interest policies established by the board of trustees. (See Appendix H, pages 1266 and 1287.)

The policies and procedures designed by the FAF board of trustees and the chairman of the FASB to prevent conflicts of interest are inadequate to fulfill their stated purpose "to establish to public satisfaction the independence and objectivity of those responsible for establishing and improving standards of financial accounting and reporting." Under its policies regarding conflicts of interest, the FASB has noted that no occasion has arisen to date requiring or resulting in disciplinary action against any members of the FASB or its staff.

In keeping with its claim of independence, the FASB has stated in describing its conflict of interest policies and procedures: "These policies are based on the premise that there can be no conflict, or the appearance of any conflict, between a Board or staff member's private interests on the one hand, and the public interest and his duties to the Financial Accounting Foundation and the FASB on the other." The FASB has also recogized that "independence and objectivity are in large measure subjective, rather than objective, qualities when viewed by the public . . ."

Despite its recognition that even the appearance of a conflict of interest is enough to subvert public confidence, the FASB's policies permit members and staff to own or hold unlimited amounts of investments which could cause conflicts of interest. The basic FASB attempt to prohibit conflicts of interest involves a description of policies in that area which is distributed to all FASB members and senior administrators. Also, a signed statement requiring an affirmation by each member that he is following those policies must be filed annually, along with a listing of all "material" investments held by a member or his immediate family.

The FASB's conflict of interest policies prohibit a member from directly or indirectly owing financial or other obligations to any former employer, business partnership, or client. In like manner, members are also prohibited from being directly or indirectly owed any financial or other obligations by any former employer, business partnership, or client. These basic prohibitions are sound policies designed to prevent FASB members from having vested financial interests in the outcome of the accounting standards they set. However, their positive effect is essentially negated by very significant exceptions to the restrictions on financial obligations.

Some minor exceptions to the flat ban on financial obligations with former employers, partnerships, or clients are permitted FASB members. For example, the prohibitions sensibly make exceptions for financial obligations arising from normal banking relationships, fixed retirement or annuity payments that are vested and not materially affected by future business operations, ownership of Government securities, and commonplace agreements not to compete or di-

vulge trade secrets. The FASB's exceptions to its ban on financial conflicts of interest, however, do not stop with such relationships. It permits members to invest freely in securities listed on a national securities exchange or traded in the over-the-counter market. FASB members are also permitted to become limited partners in investment vehicles.

Conflict of interest rules that permit unlimited investments in all types of publicly traded securities, as well as private investment consortia, are meaningless. Many of the greatest increases and decreases in stock prices that have occurred during the past decade have been occasioned by the use of accounting practices which have been—and will continue to be—the subjects of FASB consideration and decision-making.

FASB members are in a unique position to influence stock prices through their decisions on accounting standards, and to profit from investment in the securities of companies that are affected by their decisions. Although their potential influence on the prices of securities of large corporations is great, the influence of the FASB's accounting decisions on the value of investments in smaller companies and limited investment consortia is often even greater because permissible accounting practices may have a more noticeable effect on the presentation of operating results. Accounting methods are crucial to the determination of investment values because they measure costs, profits, asset values, liabilities, and other factors which affect decisions as to whether particular investments are worthwhile. In the past, use of a variety of questionable accounting methods has been instrumental in giving many investments an appearance of value which was not actually present, and has led to manipulation of securities prices.

Persons who are charged with the responsibility of setting accounting standards that will eliminate abusive accounting practices should not have any significant financial interest in the results of their decisions. Conflict of interest rules which permit FASB members to have unlimited investments in both publicly-traded securities and private consortia do not meet that requirement. Even the few restrictions that do exist for financial obligations extend only to former employers, partnerships, and clients. Conflicts of interest arising from potential business relationships are not covered at all.

Although "blind trust" arrangements do not provide complete assurance that conflicts of interest will be prevented, they do provide certain restrictions over personal control of financial activities. However, the FASB's regulations have no requirements whatever that its members be precluded from exercising total discretion and control over their investments. Thus, other than the prohibition against direct agreements with former business associates to share in their profits, FASB members essentially are not restricted in any manner from having investments which are or may be affected by the accounting standards they set.

The policies established by the FASB to prevent conflicts of interest also include some restrictions on the outside activities of its members. There are restrictions against unapproved speeches or writings, receiving fees from speeches and writings, disclosing information on FASB activities, having future employment agreements, and serving

as an officer or director of another organization. Once again, significant exceptions to these rules are permitted.

For example, FASB members are specifically allowed to serve as officers or directors of family or personal investment companies. Also, a member of the FASB from one of the "Big Eight" accounting firms recently resigned prior to the end of his term, and announced that he was returning to practice with his former firm. (See Appendix H, page 1419.) It was not publicly explained how his resignation satisfied the FASB's rule that "no Member or Director shall have any formal or informal agreement, arrangement or understanding with any person to the effect that after termination of his employment relationship with the Foundation or the Standards Board he can or will return to, or become affiliated with an employer or business partnership, or resume or enter into consulting or other similar arrangements." It seems doubtful that an FASB member would resign with an announcement of his intent to return to his previous business affiliation without some formal or informal agreement, arrangement or understanding that he was wanted back and that there was an acceptable position for him.

His resignation illustrates another problem with the policies developed by the FASB to prevent conflicts of interest. There are no effective procedures for enforcing them. Enforcement of the FASB's policies is based on the notion that persons involved in conflicts of interest will voluntarily report their violations of the rules and take steps to rectify them. That notion has been discredited by continual revelations of massive and serious wrongdoing by top members of the business community, the professions, and the government.

Many of the abuses have involved financial conflicts of interest. Almost all of them have been revealed through involuntary means. Even the SEC's "voluntary" program urging corporations to disclose improper or illegal payments was accompanied by threats of more stringent punitive measures against those failing to cooperate. Persons involved in improper or illegal activities tend to regard voluntary confession as an act that truly conflicts with their special interests.

The strongest sanction which the FASB may use against an errant member is termination of employment with the FASB. That sanction is particularly ineffective against a member who violates the prohibition against future employment agreements. In that situation, the member is leaving the FASB for a preferred outside employment opportunity anyway.

As a means of enforcing prohibitions against conflicts of interest, the FASB policies provide that a member who believes he may have a conflicting interest affecting his "independence" and objectivity should consult with one or more members of the FAF board of trustees designated to handle such problems. He is also required to make available relevant information which is reasonably requested by them. If, as a result of such consultations, the FASB member decides that he should disqualify himself from a vote or from specific functions or activities, the rules provide that he should notify the trustees and the chairman of the FASB at the earliest possible time. Apparently, each FASB member is his own judge regarding the propriety of investments or activities which could be viewed as conflicts of interest because the decision on disqualification is left to the individual members.

Unlike disqualification decisions by members of public bodies, the failure of an FASB member to disqualify himself because of a conflict of interest cannot be appealed to the courts. The Federal courts have held that the AICPA's previous standard-setting efforts merely express private opinions, and do not violate the rights of those affected by such accounting standards. For its part, the SEC has already decided in advance that FASB decisions on accounting standards are valid.

The FAF bylaws specifically provide that, notwithstanding an FASB member's disqualifying himself from voting, he may continue to participate in public hearings and the process of research, discussion, and deliberation. Instead of encouraging members to disqualify themselves whenever there is even an appearance of a conflict of interest, the FASB policies actually urge members not to disqualify themselves without careful thought. Noting that FASB members can still participate in decision-making activities after disqualifying themselves, the policies state: "However, in view of the importance and public significance of the powers, functions and activities of the Standards Board, Members should consider thoroughly, and consult to the fullest extent, with the Committee (of Trustees) before deciding to disqualify themselves on a particular vote."

"MATERIAL" INVESTMENTS

In order to enhance the value of its conflict of interest policies which depend on voluntary compliance, the FASB requires its members and senior administrators to file an annual report with the committee of FAF trustees designated to handle such matters. (See Appendix H, at page 1273.) Basically, the annual report requires each member to sign an affirmation that he understands and is obeying the FASB's prohibitions against conflicts of interest, and to attach a list of all "material" investments.

The annual report instructions clearly state that the list of "material" investments shall not be deemed to create a presumption that such investments affect an FASB member's "independence" or objectivity. As described previously, FASB members are free to invest in almost anything, and the annual report is designed merely to list the "material" investments.

From the standpoint of an individual desiring to disclose as little as possible concerning his personal investments, the FASB's definition of "material" investments is quite generous. The annual report's instructions state that, if the aggregate value on the reporting date of all securities of a particular issuer equals or exceeds the *greater* of (i) 10 percent of a member's net worth at such date, or (ii) $25,000, then those securities should be listed in the annual report. In other words, investments in individual companies that aggregate less than $25,000 for each company need not be reported. Reporting limits for wealthier FASB members may be even higher depending on the size of their net worth. Members are not required to report certificates of deposit of banks, savings and loan associations, or other such institutions, regardless of value.

Much of the public would not agree with the FASB that investments reaching $24,999 are immaterial. The reporting limitations,

however, do not really affect the public's awareness of existing or potential conflicts of interest at the FASB because the annual reports of its members are not disclosed to the public. They are disclosed only to the trustees of the FAF who are designated to handle such matters. Thus, the FASB members are accountable only to a select few members of the FAF board of trustees who are chosen by the AICPA and the other four private interest sponsors of the FASB. The public is left to accept at face value the FASB's assertions regarding the absence of conflicts of interest.

The chairman of the FASB has complete control over its staff. He is responsible for all consultations and decisions involving existing and potential conflicts of interest by staff members.

The rules of conduct governing conflicts of interest which he has issued for observance by the entire FASB staff are similar to the policies applying to FASB members and senior administrators. However, staff members are required only to sign an affirmation that they have read and understood the conflict of interest rules.

A review of the FASB's policies and procedures to prevent conflicts of interest by members and staff shows that they are essentially useless as a basis for public confidence in the independence and objectivity of the FASB. Despite pages of elaborate language, the only real restriction on conflicting investments which emerges from the FASB policies is a prohibition against agreements to share directly in the profits of previous employers or business affiliations while serving on the FASB. There are also some restrictions of questionable usefulness on the outside activities of FASB members and staff. All of the policies and regulations depend largely on self-enforcement by individuals who are expected to report and rectify their own existing or potential conflicts of interest.

Other than termination of employment with the FASB, there are no effective sanctions which can be used to enforce the rules of conduct. Even termination of employment may be ineffective in many cases. The reporting system, such as it is, can be expected to detect only the most flagrant conflicts of interest. In any event, the reports are disclosed only to a select few persons concerned with avoiding any actions which would hint of scandal at the FASB.

The FASB's conflict of interest policies are worth noting as an indication of the type of procedures which its private sponsors believe is adequate to ensure public confidence in the setting of accounting standards. However, ineffective rules are no better than complicated organization charts in achieving real or apparent independence. The FAF, the FASAC, and the elaborate system of policies and procedures simply attempt to give the FASB an appearance of independence and concern for the public in setting accounting standards.

CHAPTER VI. INFLUENCE OF THE AICPA AND THE "BIG EIGHT" ACCOUNTING FIRMS ON THE FASB

As has been described in previous sections of this study, the "Big Eight" and the other large national accounting firms control the AICPA, and the AICPA controls the FASB. The "Big Eight" accounting firms are able to control the FASB by directly influencing its operations and activities, and also through their control of the AICPA and the authority it exercises over the FASB. The controlling influence over the FASB exercised by the "Big Eight" on their own and through the AICPA takes three basic forms which are essential to the operation of the FASB—money, personnel, and organizational support. The ability of the "Big Eight" and the AICPA to control the FASB is not accidental, but was carefully conceived and written into the certificate of incorporation and bylaws of the FAF and the FASB.

Money

The first of the three essentials for operating the FASB is money. Because the FASB was designed to be dependent on voluntary contributions for most of its multi-million dollar budget, the sponsoring groups established a program which would attract volunteers with resources large enough to meet its budget. The "Big Eight" firms and the AICPA agreed to be the primary "volunteer" contributors. Substantial contributions through the FAF to the FASB are one means of controlling its activities to ensure that financial accounting standards remain compatible with the interests of the "Big Eight" and their clients.

The amounts invested in maintaining control over accounting standards through "voluntary" contributions have been substantial indeed. According to the 1975 annual report of the FASB, almost $11.9 million has been contributed to the FAF for use in operating the FASB since its founding in 1972. The accounting profession has contributed about $6 million, or 51 percent of the total amount contributed for operating the FASB.

In 1975 alone, the FAF received $4,129,201 in total contributions. The accounting profession donated $2,059,076, half of the total. (A summary of the contributions received in 1975 and 1974, along with a detailed list of every person or organization donating $1,000 or more, appears in Appendix H, p. 1232.) A review of the significant donors listed as being from the accounting profession shows that 99.6 percent of the $2,059,076 contributed in 1975 was donated by the "Big Eight," the AICPA, and 41 other accounting firms.

The AICPA has described the commitment of the accounting profession to support the FASB in Appendix E, at p. 877. As the major force behind the creation, organization and operation of the FASB, the AICPA and its members have agreed to provide $2 million in contributions each year toward its support. The AICPA has a subsidiary

organization called the Accounting Research Association whose sole function is to raise money from AICPA members for donation to the FAF.

The Accounting Research Association raises money from AICPA members in the form of annual "dues" which are computed according to a sliding-scale formula based on the size of member accounting firms.* As the only firms in the largest size category, the "Big Eight" each pay annual dues of $200,000 to the Accounting Research Association. Most of the remaining dues received by the Accounting Research Association comes from 41 other accounting firms. After paying its fund-raising expenses, the Accounting Research Association contributes the bulk of the dues it receives to the FAF for use in operating the FASB.

Dues paid to the Accounting Research Association are tax-deductible, so the taxpayer partially subsidizes the operation of the FASB. By contributing to the Accounting Research Association, the big accounting firms also add another level of organizational separation between their money and the operation of the FASB. The Accounting Research Association is merely a conduit established by the AICPA to channel money to the FAF for the FASB, but the flow of money and authority from one organization to another is important as support for the AICPA's claim that the FASB is "independent."

Collectively, the "Big Eight" firms contributed $1.6 million in 1975. That amounted to 78 percent of the $2,059,076 donated by the accounting profession in 1975. The "Big Eight" are by far the largest individual contributors to the support of the FASB. (See Appendix H, p. 1233.)

The next seven largest accounting firms also contribute substantially to the support of the FASB. Counting both direct donations to the FAF and their Accounting Research Association dues, the next seven largest accounting firms contributed a total of $286,500 to the support of the FASB in 1975. The "Big Eight" and the next seven largest accounting firms thus gave a combined total of $1,886,500. That amounts to 92 percent of the total contributions from the accounting profession for the support of the FASB in 1975.

The AICPA itself contributes a substantial amount to the FAF each year. Its stated policy is to donate $2 for each member of the AICPA, which amounted to $207,726 in 1975. Its policy on contributing to the support of the FASB reflects the attitudes of the "Big Eight" and the other large accounting firms which control the AICPA.

It should be noted that the sum of the individual contributions for support of the FASB is greater than the total contribution of $2,059,076 to the FAF which is designated as coming from the accounting profession. The excess amounts are involved in running the AICPA's Accounting Research Association and its fund-raising activities on behalf of the FAF. As previously described, the Accounting Research Association's fund-raising activities are a very real and necessary part of financing the operation of the FASB.

The FASB is a big-budget operation which receives substantial "voluntary" support from the accounting profession. About half of the total contributions to the FAF for use in operating the FASB

*See p. 120 of this study for more detail on the AICPA's Accounting Research Association and its sliding-scale dues arrangement.

come from the accounting profession. The FASB has stated that contributions from thousands of individual practitioners and local accounting firms are, in the aggregate, not significant.

The accounting profession's financial support for the FASB is not broad-based. Almost all of the money designated as contributions from the accounting profession is donated by the 15 largest accounting firms and the AICPA, which they control.

Personnel

The "Big Eight" accounting firms and the AICPA have a commanding influence on the activities of the FASB through the direct participation of their present and former partners, members, and staff in the FASB's operation. The FASB has provided this subcommittee with a table showing the memberships held by the individuals on the FAF board of trustees, the FASB, and the FASAC in the five private interest groups sponsoring the FASB. (See Appendix H, p. 1263.)

The FAF board of trustees has nine members, all of whom belong to one or more of the five sponsoring groups. Eight of the nine FAF trustees are members of the AICPA. Only one of the trustees supposedly representing the other four sponsoring groups is not also a member of the AICPA. The high concentration of AICPA members may reflect the fact that all FAF trustees are elected by the AICPA's board of directors. In addition to the control they exercise through the AICPA over the selection of all trustees, the "Big Eight" have three representatives serving directly as FAF trustees. That amounts to one-third of the members on the FAF board of trustees.

The FASB has seven members, and all of them belong to one or more of the five sponsoring groups. Six of the seven FASB members belong to the AICPA. Again, only one of the representatives from the other four sponsoring groups is not also a member of the AICPA. Three of the FASB members are from "Big Eight" firms.

The AICPA's control over the FASB is illustrated by the fact that all but one of the members on both the FAF board of trustees and the FASB are members of the AICPA. Through their control over the AICPA and its activities, the "Big Eight" firms are able to influence heavily the selection of the FASB members. The process of selection begins with election of the FAF trustees by the AICPA's board of directors, and is completed with the appointment of FASB members by the FAF board of trustees. The "Big Eight" firms also have substantial direct representation on the FAF board of trustees and the FASB.

There have been a number of representatives in the FASB organization from the AICPA's Wheat study group, which recommended that the FASB be created. The AICPA president who appointed the Wheat study group is now the chairman of the FASB. Two of the seven Wheat study group members have served as FAF trustees. A third has since become the salaried president of the AICPA. The relationship between the FASB and the leadership of the AICPA has been close.

The Financial Accounting Standards Advisory Council (FASAC), which is supposed to provide the FASB with outside advice, is also dominated by members of the five FASB sponsoring groups. About

half of the 31 FASAC members belong to the AICPA, and six of them are from "Big Eight" accounting firms. The heavy influence of the AICPA and the "Big Eight" is evident even on the FASAC where the stated objective is to gain a broad spectrum of opinions on accounting matters.

The FASB's professional staff is dominated by former "Big Eight" and AICPA employees. (A list of its professional staff and their business affiliations immediately prior to joining the FASB staff appears in Appendix H, p. 1298.) This subcommittee was able to compare the FASB's list of professional staff with the 1974 list of AICPA members published by the AICPA. Overall, 23 of the 32 FASB professional staff members are also listed as being members of the AICPA. That amounts to 72 percent of the total FASB professional staff.

The concentration of AICPA members on the FASB staff is much greater in the higher staff positions and the positions which have the greatest impact on the accounting standards issued by the FASB. Three of the four FASB staff directors are members of the AICPA. Two of them were previously employed on the AICPA staff. All of the seven FASB project directors and the two FASB technical advisors belong to the AICPA. Four of the five FASB Fellows on its technical staff are AICPA members, along with two of the four FASB research and technical associates, and four of the six FASB technical assistants. AICPA members are thus well-established in the hierarchy of the FASB professional staff.

The big national accounting firms are also well-represented on the professional staff of the FASB. Ten of the 32 staff members, including four of the seven FASB project directors, were previously with "Big Eight" accounting firms. Another three FASB staff members were previously with three of the next seven largest accounting firms. Forty-one percent of the FASB professional staff came directly from the Nation's 15 largest accounting firms.

Organizational Support

The organizational support of the AICPA and the "Big Eight" accounting firms is necessary for the FASB to have its pronouncements accepted by the businesss and financial community. The AICPA has been the primary private source of authority for accounting standards since 1938. As the auditors for the vast majority of large corporations, the "Big Eight" firms are involved in applying accounting standards in situations that have the greatest impact on the public.

Accounting standards set by the AICPA have been accepted as authoritative over the years because of the expertise and impartiality which have been associated with the image of the accounting profession and its institutions. The SEC's acceptance of accounting standards developed by the AICPA has given them the stamp of Federal Government approval. The SEC formalized its approval of accounting standards set by the FASB through the issuance of Accounting Series Release 150. The AICPA has thus been able to establish itself as the authoritative source on accounting standards within the private sector.

By creating the FASB, the AICPA has attempted to organize formally its authority to set accounting standards within the private sector, so that the FASB will be perceived as an "independent" body.

No other private organization could create a body to set accounting standards and immediately bestow upon it the reputation of being the accepted source of authority within the private sector. Without the support of the AICPA, the FASB could not have been created within the private sector as the instant authoritative source for accounting standards.

Acceptance of the FASB's pronouncements by the "Big Eight" accounting firms is also very important. They have agreed to a system of enforced compliance with the accounting standards developed by the FASB. The AICPA's code of ethics now requires that FASB pronouncements be followed, and the SEC has its own rule (ASR 150) to force compliance with standards set by the FASB. These requirements are significant because some major accounting firms had refused to abide with an accounting standard promulgated by the AICPA's previous standard-setting body. Accounting standards cannot be effective if the "Big Eight" refuse to conform to them.

Summary

The AICPA and the "Big Eight" accounting firms are the most important and influential supporters of the FASB. They were the major force in creating the FASB, and carefully organized its structure so that they would be able to control its operation. Their controlling influence has been augmented by their substantial financial, personnel, and organizational support for the FASB.

The accounting profession provides approximately one-half of the FASB's financial support from contributions. That amounts to $2 million per year from the accounting profession. Almost all of that is contributed by the "Big Eight" firms and the AICPA. Financial support for the FASB within the accounting profession is narrowly concentrated among the largest accounting firms and the AICPA which they control.

The AICPA and the "Big Eight" accounting firms play a key role in the membership of the FAF, the FASB, the FASAC, and the professional staff of the FASB. Almost all of the important positions in the FASB organization are held by AICPA members. A substantial number of them are from "Big Eight" firms. The task forces which perform most of the preparatory work on accounting standards issued by the FASB are also influenced by AICPA members and representatives of the "Big Eight" firms. (See Appendix H, p. 1423.)

The organizational support of the AICPA and the "Big Eight" firms is vital to the FASB. That support ensures that FASB pronouncements will be accepted as the authoritative source on accounting standards within the private sector. For its part, the SEC has formally recognized the FASB as the authoritative source on accounting standards which must be used to satisfy the financial disclosure requirements of the Federal securities laws.

CHAPTER VII. INFLUENCE OF THE OTHER PRIVATE SPONSORING GROUPS ON THE FASB

In terms of financial, personnel, and organizational support, the AICPA and the "Big Eight" accounting firms are by far the most substantial influence on the FASB and its activities. The major factor which differentiates the FASB from the previous two standard-setting bodies organized by the AICPA is the participation of other private sector groups in the sponsorship of the FASB.

As has been described, the other private sponsors of the FASB play a more limited role than the AICPA in the operation of the FASB, but their participation as sponsors is important. It gives the FASB an appearance of broad private sector support, while simultaneously removing four influential private groups from the ranks of potential FASB critics. The other sponsors also help defray the substantial expense of operating the FASB.

In addition to the AICPA, the four private groups sponsoring the FASB are the Financial Executives Institute, the National Association of Accountants, the American Accounting Association, and the Financial Analysts Federation.* This subcommittee requested information from each of these groups to determine the interests they represent. Their responses to the subcommittee's request are contained in Appendix G.

Collectively, these sponsoring groups and their members contribute approximately half of the money used to operate the FASB. That amounted to about $2 million in 1975. Contributions to the FASB from the various groups and their members are not equal. (A summary of their contributions, including a list identifying all of those contributing $1,000 or more, appears in Appendix H, p. 1237.) Because donations to the FASB are tax deductible, the taxpayer partially subsidizes these contributions.

The AICPA organized the FASB in a manner that permits the other four private sponsoring groups to nominate a minority of the members on the FAF board of trustees, which appoints the seven FASB members. The AICPA's ability to control the FASB was assured by vesting the sole authority to elect the members of the FAF board of trustees in the AICPA's board of directors. However, the other four sponsors have achieved representation on the FAF, the FASB, and the FASAC as a result of their nominating role and the desire of the AICPA to have the FASB perceived as a broad-based venture.

The FASB has provided this subcommittee with a table showing the memberships of the persons on the FAF and the FASB in the various groups sponsoring the FASB. (See Appendix H, p. 1263.) The

* The Securities Industry Association was added as the sixth sponsor of the FASB on 1 October, 1976. Although added as a sponsoring group too late to be included in this study, the Securities Industry Association reportedly represents the interests of more than 800 investment banking firms. Its addition as an FASB sponsor does not significantly affect the findings of this study.

table shows that, in all but two cases, the individuals supposedly representing the other four sponsoring groups are also members of the AICPA. One FAF trustee and one FASB member belong to four of the five sponsoring groups. It is not possible for this subcommittee to determine which interest is being represented when an individual belongs to more than one sponsoring group. However, the large number of individual memberships in the AICPA does indicate that the FAF trustees and FASB members are compatible with the policies and programs of the AICPA.

Financial Executives Institute

After the AICPA, the Financial Executives Institute is probably the most important sponsor of the FASB because of the substantial amounts of money its members contribute to the FASB. The 1974 annual report of the FASB states that more than 1,200 corporations contributed approximately $1.9 million to support of the FASB in that year, and that 80 percent of the corporate total was traceable to the efforts of the Financial Executives Institute. That amounts to about $1,520,000, or 38 percent of the total contributions in 1974.

In 1975, 1,397 corporations donated $1,928,349 to the FASB's support. Assuming that 80 percent of that amount was again traceable to the efforts of the Financial Executives Institute, its members contributed about $1,543,000 in 1975. That equals 37 percent of the total contributions received for FASB operations in 1975. The FASB data on corporate contributions in Appendix H at page 1237 shows the detail on such contributions for both 1974 and 1975.

Corporate contributions to FASB support are different in some respects from the accounting profession's contributions. Apparently, all of the corporate donations are made directly to the FAF for operating the FASB. There is no intermediary organization—such as the AICPA's Accounting Research Association—which collects "dues" for donation to the FASB through the FAF.

Contributions from individual corporations are also much smaller in amount than contributions from individual accounting firms. Most corporate contributions are less than $5,000. Even such corporate giants as American Telephone & Telegraph Company and the Exxon Corporation contributed only $40,000 each. Individual corporate contributions can be lower because there are so many corporations with sufficient resources and self-interest to contribute to the operation of the FASB.

The accounting profession's financial resources and direct self-interest in the reporting of publicly-owned corporations are primarily concentrated among a small number of large national accounting firms. The vast majority of the Nation's several hundred largest corporations are audited by only eight accounting firms. As a result, each large national accounting firm must donate a proportionately greater amount to support the FASB in order to have the accounting profession equal the total contributions from the corporate sector and other sources.

The fact that each of several hundred major corporations has a sufficient self-interest in the FASB to contribute to its operation is reflected by the large number of relatively small corporate contributions. Relative to the number of existing and potential corporate con-

tributors, however, the contributions for the FASB from the corporate sector are concentrated among the largest corporations. The data provided by the FASB shows that 580 of the Nation's largest corporations donated $1,746,984 of the $1,928,349 designated as being contributed by the corporate sector in 1975. That amounts to 91 percent of the total corporate contributions in 1975.

Corporate financial support for the FASB is not really so broad-based as it first appears. There is also a great degree of mutual self-interest in the type of accounting standards set by the FASB between the large accounting firms and the large corporations which provide the bulk of the FASB's financial support. In nearly every case, the 580 largest corporate contributors are audited by one of the "Big Eight" accounting firms.

The Financial Executives Institute has 9,241 members representing approximately 5,000 companies. Membership is on an individual basis only, and is open to executives who have major financial responsibilities in companies or financial institutions, as well as to qualified educators. The Financial Executives Institute had revenues of $1,671,909 in 1975, most of which came from membership dues. A description of the Financial Executives Institute and its membership appears in Appendix G, page 1149.

One of the Financial Executives Institute's major functions is to respond, from the point of view of business, to various agencies of the government and to private organizations, such as the FASB, on proposed accounting standards and reporting practices and requirements. "A statement by FEI is the view of corporate management," says the organization's membership solicitation brochure. The Financial Executives Institute is actively involved in promoting the collective views of corporate managements before Congress, the SEC, the CASB, the IRS, Federal Government departments, the FASB, and the stock exchanges.

Two FAF trustees, one FASB member, and 12 FASAC members belong to the Financial Executives Institute. The Financial Executives Institute does not contribute directly to support of the FASB, but it does undertake an organized effort to encourage the corporations employing its members to contribute. As described previously, that effort has been very successful.

The Financial Executives Institute publishes the "Financial Executive," a monthly magazine focusing on corporate financial matters, and the "FEI Bulletin," which summarizes the organization's activities. The related Financial Executives Research Foundation conducts studies and publishes reports on topics of interest to the Financial Executives Institute.

Two recent examples of the Financial Executives Institute's efforts to influence Congress are included in Appendix G, at pages 1171 and 1167. The first is a letter sent to the House and Senate conferees on the Federal Energy Administration Act. The letter urges the conferees to reject a Senate amendment which would permit the Federal Government to develop accounting practices to be followed by energy producing companies. The Financial Executives Institute recommendation is to leave the development of such accounting standards to the private sector's FASB, which it co-sponsors.

The second example is a letter to Members of Congress concerning the retention of a controversial tax provision that benefits multi-

national corporations. That letter includes the summary of a study purporting to show that removal of the tax provision would cause a significant loss of jobs within the United States.

As a sponsor of the FASB, the Financial Executives Institute is important because it raises a substantial portion of the money used in operating the FASB. It is an active partisan on behalf of business interests, and openly promotes controversial views on the type of accounting and financial reporting which should be required of businesses. Many of its members represent corporations which are clients of the "Big Eight" accounting firms, and share their interest in retaining accounting standards which permit great flexibility and creativity in reporting to investors, creditors, and the public on corporate activities.

The Financial Executives Institute and its members have an obvious vested interest in the outcome of the FASB's standard-setting efforts. The influence which the Financial Executives Institute has on the FASB through its substantial financial support and its participation in the FASB organization is clearly oriented toward having the FASB set accounting standards that are suitable to business interests.

Many of the corporations of which Financial Executives Institute members are leaders have resisted attempts to develop a uniform system of meaningful accounting standards to inform the public accurately on the results of corporate activities. The participation of the Financial Executives Institute as one of the five private sponsors of the FASB is another indication of the FASB's inability to foster public confidence in the quality of information conveyed by corporate financial reports.

National Association of Accountants

The National Association of Accountants is an organization dedicated to promoting the views of its members regarding the use of accounting practices. Although the two organizations have somewhat different purposes, the membership of the National Association of Accountants overlaps the membership of the Financial Executives Institute.

The members of the National Association of Accountants are primarily corporate controllers, financial executives, and accountants. It has about 70,000 members and an annual budget of $4.4 million. Most of its revenues come from membership dues. (Detailed information on the National Association of Accountants appears in Appendix G, page 1173.)

Since 1972, the National Association of Accountants has directly contributed $103,500 for the operation of the FASB. Approximately $25,000 has also been spent in soliciting its membership for individual contributions. According to the FASB, the National Association of Accountants contributed $75,000 toward support of the FASB in 1975.

Four members of the National Association of Accountants serve on the FAF board of trustees, one as an FASB member, and 10 as members of the FASAC. All of the 15 members of the National Association of Accountants serving in the FASB organization belong to one or more of the other private groups sponsoring the FASB, so none of them exclusively represents the National Association of Account-

ants. However, the National Association of Accountants has designated one FAF trustee as the specific representative of its interests.

The National Association of Accountants actively promotes the views of its members on controversial issues before the Federal Government and private organizations. Its several committees develop its views and communicate them to Congress, the CASB, the SEC, the IRS and other Federal agencies, as well as the FASB. A list of the letters of comment made by the National Association of Accountants since January 1, 1975 is included in Appendix G, page 1188. Copies of two letters of comment are also included as examples of the positions taken by the National Association of Accountants.

The first letter is to the Subcommittee on Economic Stabilization of the House Committee on Banking, Currency, and Housing. In that letter, the National Association of Accountants lamented the promulgation of a cost accounting standard by the CASB which requires that government contractors use actual useful asset lives when charging the Federal Government for depreciation costs. The letter states that higher charges to the Federal Government based on rapid write-offs are necessary because the profits earned by government contractors are not adequate.

The letter also states that the National Association of Accountants "is not concerned with consistency when considering reporting models with divergent functions." That statement indicates the National Association of Accountants would be a negative influence on any efforts by the FASB to develop a uniform system of meaningful accounting standards.

The second letter is to the CASB as comment on its proposal to include a portion of return on capital as a "cost" to be charged to the Federal Government by private contractors. That proposal has since been adopted by the CASB. The National Association of Accountants concluded that the CASB was not going far enough to guarantee that government contractors would earn a profit on all Federal contracts. It recommended that inflated replacement values be used as the base for computing capital return as a "cost," and that the CASB should study ways of increasing contractors' profits.

Like the Financial Executives Institute, the National Association of Accountants and its members have an obvious vested interest in the type of standards set by the FASB. The National Association of Accountants actively promotes business interests on controversial issues, and has pursued those interests through its participation in the activities of the FASB. Although it does not have as much influence on the FASB as the Financial Executives Institute in terms of financial support, the National Association of Accountants and its members are substantial contributors to the FASB and wield considerable influence on accounting matters. The National Association of Accountants, as a sponsor of the FASB, is committed to corporate interests and is ill-suited to provide assurance that the FASB operates independently in the public interest.

American Accounting Association

The American Accounting Association primarily represents academic accountants and others interested in accounting research and

education. This organization has approximately 12,000 members, about 10,000 of whom reside in the United States. Approximately 4,500 of the members residing in the United States are accounting professors at universities and colleges.

The annual revenues of the American Accounting Association in 1975 were $645,542. Membership dues accounted for 41 percent of the total revenues, with the remainder coming from the sale of publications, investment income, and contributions. Almost one-fourth of the American Accounting Association's revenues came from contributions to the various funds it has established. (A description of its membership and activities appears in Appendix G, page 1199.)

The sources and amounts of contributions received by the American Accounting Association are shown in its financial statements. Most of the $153,820 in contributions was donated by foundations associated with the "Big Eight" accounting firms. Many of the American Accounting Association's activities are funded in whole or in part with contributions from the "Big Eight" firms.

Because of overlapping memberships, some American Accounting Association members are also active in the AICPA. The AICPA's incoming chairman of the board, president, and three other AICPA board members belong to the American Accounting Association. The vice-chairman of the AICPA's Cohen commission, two members of the AICPA's Wheat study that recommended establishing the FASB, and four members of the AICPA's Trueblood study on the objectives of financial statements are members of the American Accounting Association.

Three American Accounting Association members serve on the FAF board of trustees, four serve as FASB members, and 11 serve as FASAC members. Of the 18 American Accounting Association members serving in the FASB organizational structure, only one member serving on the FASB exclusively represents the American Accounting Association. The American Accounting Association contributed $6,876 for the operation of the FASB in 1975 under a policy of donating $2 per teaching member who resides in the United States.

Members of the American Accounting Association form committees to comment on proposals by the FASB. Such comments represent the views of a majority of the members participating, but expressly do not represent the official views of the American Accounting Association.

As a sponsor of the FASB, the American Accounting Association ostensibly does not have a direct vested interest in the type of standards set by the FASB, as do the AICPA, the Financial Executives Institute, and the National Association of Accountants. The American Accounting Association also exerts little influence as a source of financial support for the FASB. However, the close relationship between the American Accounting Association on the one hand, and the AICPA and the "Big Eight" accounting firms on the other, raises some doubts as to the complete objectivity of the American Accounting Association in co-sponsoring the FASB. Those doubts are strengthened by the fact that all but one of the 18 American Accounting Association members serving in the FASB organization are primarily identified with business interests or other sponsoring groups that have a self-interest in the type of standards set by the FASB. (See Appendix H, p. 1263.)

Financial Analysts Federation

The Financial Analysts Federation is an organization of 14,000 members who are primarily engaged in investment analysis and portfolio management. It had a budget of $1.4 million in 1975. (A detailed description of its membership and activities appears in Appendix G, page 1206.)

The major activities of the Financial Analysts Federation involve the promotion of sound financial analysis and accounting methods. It publishes the "Financial Analysts Journal," and has established a program of chartered financial analysts to improve the stature and practice of financial analysis. It also comments on topics of interest to its members before the SEC and the FASB.

One Financial Analysts Federation member serves on the FAF board of trustees, one is an FASB member, and four are FASAC members. The FAF trustee and two of the four FASAC members represent the Financial Analysts Federation exclusively. The Financial Analysts Federation contributed $7,000 for the operation of the FASB in 1975, but undertook a fundraising campaign among its members that yielded $195,625 for the FASB during 1973.

Of the five private groups sponsoring the FASB, only the Financial Analysts Federation and its members have an apparent interest in developing accounting standards which clearly convey the results of corporate activities to the public. Most of its members are *users of* corporate financial statements, and the quality of their investment analyses is directly related to the quality of information they receive from financial statements and other sources. However, some investment analysts and portfolio managers may have a vested interest in investments which depend on the use of questionable accounting practices to create an image of financial success. The Financial Analysts Federation appears to have the least influence as a sponsor of the FASB, and the FASB has yet to establish the type of meaningful accounting standards which would be most beneficial to investors and other users of financial statements.

CHAPTER VIII. ACTIVITIES OF THE FASB

The primary purpose of the Financial Accounting Standards Board is to establish accounting standards, but the FASB and its members engage in other activities which are intended to promote its interests. A review of certain FASB activities indicates that it is not independent of its sponsors and their interests, and is therefore not suited to establish accounting standards in the public interest.

Private Meetings

As part of its efforts to build an image of independence, objectivity, and fairness, the FASB developed rules of procedure for establishing accounting standards which permit the public to comment on proposed standards before they are finally issued. The FASB refers to its rules of procedure as evidence for its frequent assertion that it is serving the public interest. The SEC has noted that the FASB's procedural rules are similar to those of a governmental body, and that the rules followed by the FASB in establishing accounting standards are a primary reason for the SEC's official recognition of FASB standards. (See page 179.)

On page nine of its 1975 annual report, however, the FASB described a series of private meetings with persons having vested interests in the standards set by the FASB:

> In an effort to develop a broader sense of the views of our "constituency," we are undertaking a series of meetings with prominent public accountants, businessmen, and members of the academic community. It is anticipated that these meetings, which are not addressed to specific technical issues, will be highly productive in providing us with insight into the thinking of these knowledgeable individuals, and with a clearer understanding of how we may even better fulfill our responsibilities to the public-at-large.

This subcommittee requested that the FASB provide a list of its private meetings with outside parties, along with the purpose and participants at each meeting. The subcommittee also asked if any meetings were planned with groups representing interests other than "prominent public accountants, businessmen, and members of the academic community." The FASB's response to this subcommittee request is included in Appendix H at page 1347.

A total of 11 meetings had been held with outside parties as of 15 May, 1976.

Two of those meetings were with representatives of the FASB's sponsoring groups, as well as a few representatives from the Association of Government Accountants and the Institute of Internal Auditors. The Association of Government Accountants primarily represents accountants working for the Federal Government, and the Institute of

Internal Auditors represents accountants working directly for businesses.

Two of the 11 meetings were with representatives of accounting firms, and were sponsored by the AICPA. At the first meeting, the accounting firms represented were the "Big Eight" and three of the next seven largest accounting firms. All of the "Big Eight" and next seven largest accounting firms were represented at the second meeting. The president and other officials of the AICPA were present at both meetings.

Three of the FASB's meetings were held directly with "Big Eight" firms—Haskins & Sells (with Honeywell, Inc.), Peat, Marwick, Mitchell & Co., and Arthur Andersen & Co. Another of the FASB's meetings was with the "public review board" which Arthur Andersen & Co. hired to review the quality of the firm's practice.

The FASB met twice with representatives of major corporations. The first was with the Council of Financial Executives of the Conference Board, and the second was with members of the Financial Executives Institute.

Of the 11 meetings with outside parties held by the FASB, only one was with a group not primarily representing the major accounting firms and big business interests which sponsor the FASB. That meeting was with two individuals representing financial officials of municipalities.

As of May 15, 1976, the FASB had scheduled three more meetings with outside parties which were subsequently held. One was another AICPA-sponsored meeting with representatives of medium-sized accounting firms. The second meeting was with Arthur Young & Co., one of the "Big Eight" firms. The third meeting was hosted by the Business Roundtable, an influential business lobbying group comprised of the chief executives of large corporations. The board chairmen of 11 of the Nation's largest corporations and banks, along with the vice-chairman and president of two others, met with the FASB at a private club in New York City. (See Appendix H, page 1421.)

It is clear that the "constituency" whose views are providing "insight" for the FASB are almost exclusively major accounting firms and big business interests. Those are the same interests which sponsor the FASB and are its primary financial supporters. The constituency being heard in private meetings with the FASB has substantial financial self-interest in the type of accounting standards set by the FASB.

The FASB told the subcommittee that it has arranged meetings with outside parties to obtain a broader range of views than is offered by the 32-member FASAC. As with the FASAC, however, the views sought by the FASB always center on the major accounting firms and big business interests that are its sponsors.

The FASB also said that it does not plan to meet with segments of the public who may have interests different from those of "prominent public accountants, businessmen, and members of the academic community." The following reason was given:

> In meeting with the broad range of individuals and organizations described above, the FASB's intent is to have direct contact with responsible representatives of groups having a capability to provide meaningful information and insight

> concerning the establishment of financial accounting standards. Therefore, meetings have not been held or planned with persons or groups other than those who are knowledgeable about the problems and requirements of financial accounting and reporting.

This study has previously described how the establishment of accounting standards involves social issues which affect the public in a broad manner. The failure of the FASB to seek the views of small accounting firms, local businessmen, consumer groups, small investors, creditors, and other segments of the public indicates that the FASB is either insensitive to their needs, or has not sought "responsible representatives" of those interests. This subcommittee has found many responsible representatives from various segments of the public during the course of its study. Most of them have provided the subcommittee with meaningful insight concerning the problems and requirements of financial accounting and reporting.

Regarding its meetings with outside groups, the FASB stated that its members and staff meet regularly with the AICPA's Accounting Standards Executive Committee. That committee is dominated by the "Big Eight" accounting firms and represents their views. (See page 89.) The FASB also stated that its members and staff meet with the members and staffs of the SEC and the Cost Accounting Standards Board.

Public Statements

To publicize the FASB and help gain acceptance for its pronouncements, the chairman and the vice-chairman have spoken before selected groups within the business and financial community. The speakers have generally maintained that the FASB is well-suited to establish accounting standards, that it is making real progress, and that the FASB will not be able to succeed unless all of the various financial and business interests give the FASB political support. Warnings of Government intervention accompany the plea to help the FASB succeed.

Speeches by the chairman and vice-chairman of the FASB illustrate the FASB's efforts to build strong political support for its activities within the business and financial community. The first example is an article entitled "The Financial Reporting Environment" which appeared in the January, 1976 issue of the "Journal of Commercial Bank Lending." It was based on a talk given by the vice-chairman of the FASB during the Fall of 1975 regarding the role and activities of the FASB. The noteworthy point in the article is the admission by the FASB's vice-chairman that private sector efforts to achieve a meaningful system of accounting standards have failed. "Unfortunately," he said, "after almost 40 years of standard setting by a variety of more or less authoritative bodies, an established set of objectives does not exist."

He continued by expressing the hope that the FASB would succeed where previous efforts had failed:

> The need for such direction may not be fully understood by anyone who has not been intimately involved in the standard setting process, but I can assure you that the need is real—

> indeed, it is critical. Personally, I am impressed and optimistic about the determination of the seven members of the FASB to succeed where our predecessors have failed in establishing direction and predictability by means of an explicit conceptual framework for financial reporting.

A similar position had been taken in 1974 by the FASB chairman. He addressed the Economic Club of Detroit on the subject: "Standards for Financial Reporting: Will Washington Listen to the Private Sector?" He described his organization's progress and predicted its success. Noting the FASB's close relationship with the SEC, he expressed concern that the commission had become too active in determining accounting matters that affect the public. The SEC, he suggested, should "slow down" its efforts in deference to the FASB.

This year, however, the FASB chairman departed from the positive-thinking approach which he and the vice-chairman had followed. His speech to the Third Annual Securities Regulation Institute (see Appendix H, p. 1398) was different in tone and outlook from his speech two years earlier. The chairman admitted that his organization is failing to achieve its goal because of political pressures being exerted by parties with vested interests in retaining the flexible accounting alternatives which are presently available.

After reciting a brief history of the manner in which previous standard-setting bodies within the private sector had failed, he concluded that political pressure from vested interests caused the demise of the AICPA's Accounting Principles Board, the FASB's immediate predecessor. He also recognized that the determination of accounting standards involves social issues affecting the public. The chairman told of his amazement that only 37 percent of those responding to an FASB discussion memorandum agreed with the conclusion that the basic objective of financial statements is to provide information useful for making economic decisions. Twenty-two percent of the respondents recommended that such a conclusion be rejected out-of-hand, and 10 percent insisted that it needed further study.

One of the most disturbing episodes described by the FASB's chairman was the position taken by the SEC in response to an FASB proposal that was opposed by the insurance industry. He told how the FASB was advised by the SEC that the commission could not support an approach so vehemently opposed by industry. The chairman concluded with the admonition that "if we falter, Government stands ready to do for us what we can't do for ourselves."

Lobbying

The FASB's 1974 annual report states: "The FASB has neither a mandate nor a motive to attempt to influence legislation." Yet the FASB has undertaken at least one campaign to lobby Congress and influence legislation.

The FASB successfully sought deletion of a section of the Energy Conservation and Oil Policy Act of 1975 which would have directed the SEC to establish uniform accounting standards for oil and gas companies. That section was necessary because the private sector has never developed uniform accounting standards for oil and gas companies. The FASB opposed the section because it required the SEC

to set accounting standards directly, rather than relying upon the FASB. (See Appendix H, 1334.)

The FASB notified the House and Senate conferees on the Energy Conservation and Oil Policy Act of 1975 that it was undertaking a project to establish uniform standards for those companies. The FASB wanted three years to complete its project. Congress agreed to a two-year development period.

The FASB's primary argument against having the SEC establish accounting standards for oil and gas companies was that the commission would challenge the general authority of the FASB to establish accounting standards. The FASB focused on the "benefits" of the special prerogatives which the SEC has granted it. The FASB did not express concern over the failure of the private sector to establish uniform accounting standards, which was the impetus for congressional action regarding the accounting standards used by oil and gas companies.

The chairman of the FASB explained his views in his letter to the House and Senate conferees:

> The second major concern we have with the requirement that the SEC prescribe accounting practices "by rule" is that it would seriously disrupt the productive and cooperative relationship between public and private sectors that has existed for more than four decades, and which has contributed greatly to progress in financial accounting and reporting standards and capital formation. If the SEC rulemaking procedure were to be imposed on top of our due process, the FASB's effectiveness as the standard-setting body would be significantly challenged.

Similarly, a separate letter to conferees from the FAF board of trustees praised the "existing framework which has proved successful for over 40 years in establishing and improving accounting principles and standards." (See Appendix H, p. 1341.)

These statements praising the "success" of relying upon the private sector to establish uniform and meaningful accounting standards stand in direct contrast to the admissions by the FASB's chairman and vice-chairman in their public statements that the private sector has failed to establish such standards. (See page 168.) The FASB spoke of success when it was attempting to protect its privileged position from actions by Congress, but it spoke of past failures when it was attempting to generate support for its activities from the business and financial community.

On March 9, 1976, the FASB testified regarding the progress of its project to establish uniform accounting standards for oil and gas companies before the Senate Committee on Interior and Insular Affairs. (See Appendix H, p. 1317.) There are two points of particular interest in the FASB's testimony.

The first is that the FASB expects to establish uniform standards for oil and gas companies within the two-year development period mandated by Congress. Despite its admission that such standards have been studied extensively for more than 10 years, and that its predecessor, the Accounting Principles Board, had published a research study and held a public hearing on the subject, the FASB had originally told

Congress that three years would be necessary to establish uniform accounting standards for oil and gas companies.

The second point of interest is the recognition by the FASB that its primary responsibility in setting accounting standards is to serve the public interest. The chairman of the FASB testified:

> We must always be cognizant, however, that our primary responsibility is to serve the public interest. That is the standard against which the success of our work will ultimately be judged.

Despite its expressed intent to serve the public, the FASB has relied upon its usual procedures in developing uniform accounting standards for oil and gas companies. The FASB testified that it has followed its normal practice by appointing an 18-member task force of knowledgeable individuals to draft the FASB's discussion memorandum on accounting standards for oil and gas companies.

As previously described on page 146 of this study, however, that task force is comprised almost entirely of representatives from big oil, gas, and mining companies, their "Big Eight" auditors, and large institutional investors with significant holdings in those companies. Almost all of the task force members have an apparent conflict of interest in the work being performed for the FASB. The composition of the task force does not support the FASB's claim that its primary responsibility is to serve the public interest.

Accounting Standards

The FASB became the private sector's authoritative body for setting accounting standards on 1 July, 1973 when it succeeded the AICPA's previous standard-setting body, the Accounting Principles Board. Since that time, the FASB has been establishing accounting standards in accordance with its elaborate procedures designed to give the appearance of meaningful public participation in the standard-setting process.

Despite the fact that it is merely a better organized and funded version of previous AICPA efforts to establish accounting standards within the private sector, the FASB and its sponsors maintain that it is making real progress in bringing uniformity and more meaning to the body of accounting standards used by businesses in reporting their financial results to the public. The FASB takes pride in its procedures for recognizing accounting problems and dealing with the most important ones on a priority basis. The FASB views itself as the solution to difficulties which have prevented establishment of uniform and meaningful accounting standards in the past.

This study has already shown that there is no reason to expect that the FASB will act against the private interests which control it. Those special interest groups have had the opportunity to establish uniform and meaningful accounting standards for 40 years, but have resisted attempts to achieve that goal. A review of the accounting standards established by the FASB during the past three years shows that it is following in the same direction as previous AICPA standard-setting bodies.

During its three-year existence, the FASB has issued 12 "Statements of Financial Accounting Standards." Those standards have

addressed accounting problems of varying significance, but they have not resolved such problems in a manner which results in meaningful, as well as uniform, treatment of specific business transactions. Nor have they seriously threatened the accounting prerogatives of various special interest groups in the business community.

FASB Statement No. 2, "Accounting for Research and Development Costs," ruled that such costs must be charged against income as they occur. This ruling primarily affected small, developing companies by reducing the earnings they could report to investors in the early years of a major research project. Most large corporations were already charging research and development costs against current income.

The FASB ruling included a provision that spared the few large corporations, such as Lockheed Aircraft Corporation and McDonnell-Douglas Corporation, which stood to be seriously affected by writing off accumulated research and development costs against current income. It permitted companies to restate their earnings in previous years to reflect research and development costs incurred, but not originally charged against income in those years. That provision enabled companies to avoid a disastrous decline in their current annual earnings, but was inconsistent with a preferred accounting practice—currently proposed by the FASB as a rule—that all adjustments should be reflected in current income at the time they are made.

In Statement No. 7, "Accounting and Reporting by Development Stage Enterprises," the FASB ruled that developing companies must adhere to the same standards as fully established companies. By prohibiting the use of special standards for developing companies, the FASB helped to solidify the competitive position of established companies against potential major competitors in the development stage. Promulgation of this standard was a benefit, rather than a threat, to the established corporations and accounting firms which are the primary sponsors of the FASB.

The FASB failed to establish uniform accounting treatment of business transactions in two important standards which were issued. In Statement No. 9, "Accounting for Income Taxes—Oil and Gas Producing Companies," the FASB permitted oil and gas companies a choice of two methods for reporting interperiod tax allocations. It failed to require the use of a single method even though this accounting problem was precipitated by the Tax Reduction Act of 1975, and entrenched use of multiple accounting methods was not a significant consideration.

The standard promulgated in Statement No. 12, "Accounting for Certain Marketable Securities," also failed to establish uniformity. The FASB ruled that changes in value of marketable equity securities must be included in determining net income, but only when such securities are classified as "current assets." Changes in value of marketable equity securities not classified as "current assets" and marketable debt securities were not covered by this ruling, and may be reported using alternative accounting methods.

Furthermore, the FASB specifically provided that specialized industry accounting practices with respect to marketable equity securities may continue to be used by investment companies, brokers and dealers in securities, stock life insurance companies, and fire and casualty insurance companies. Such companies are some of the largest

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holders of marketable securities. By permitting them to use specialized accounting practices, the FASB assured that the earnings of many companies most in need of this accounting reform would not be affected by its coverage.

The goal of establishing a system of uniform and meaningful accounting standards has so far remained as elusive as ever under the direction of the FASB. It is currently in the process of issuing final accounting standards on such important matters as accounting for leases, accounting for business combinations, and financial reporting by segments of a business. Standards issued previously by the FASB indicate that it will not take the decisive action necessary to correct abuses in those areas of financial accounting and reporting.

CHAPTER IX. ACCOUNTING RESPONSIBILITIES OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission has important responsibilities regarding the development and application of financial accounting standards used by corporations which must report to the SEC and the public under the requirements of the Federal securities laws.

In the Securities Act of 1933 and the Securities Exchange Act of 1934, Congress directed the SEC to protect the public from false and misleading information by requiring publicly-owned corporations to disclose financial and other information in a manner which accurately depicts the results of corporate activities. Congress gave the SEC broad authority to establish accounting and reporting standards as part of its mandate to administer and enforce the provisions of the Federal securities laws.

A review of the SEC's record on accounting and reporting matters shows clearly that it has seriously failed to protect the public interest and fulfill its congressional mandate.

Authority and Responsibility

Having created the SEC to ensure that proper accounting and reporting standards were instituted, Congress required that corporate financial statements be certified by independent auditors as a means of providing independent assurance to the public that proper accounting and reporting standards were in fact being used by individual corporations.

At the request of this subcommittee, the SEC prepared a brief summary of its authority and responsibility to establish accounting standards, and to compel compliance with such standards. (See Appendix I, page 1450.)

That summary describes the broad authority given to the SEC by Congress, both to establish accounting standards used by publicly-owned corporations, and to require that such corporations and their independent auditors adhere to the standards established by the SEC.* The requirement that financial statements of publicly-owned corporations be certified by independent auditors is also described.

Thus, independent auditors share the SEC's responsibility to the public. Their role in assuring compliance with the provisions of the Federal securities laws is essentially a public service role which Congress might very well have assigned to the SEC or some other governmental authority.

The summary of accounting authority and responsibility prepared by the SEC describes the close relationship that has developed between

*The SEC issues accounting releases as a means of stating its policies or findings on certain accounting matters. The SEC has provided this subcommittee with a list of such accounting releases which its chief accountant considered particularly important. (See Appendix I, page 1446.)

the SEC and the AICPA, which is controlled by the "Big Eight" and other large national accounting firms. It also illustrates the role reversal which the SEC has deliberately permitted to occur in failing to exercise its congressional mandate. Instead of sharing compliance responsibilities with independent auditors following standards established by the SEC to protect the public, the SEC has acquiesced in permitting the AICPA to establish auditing and accounting standards directly on behalf of the accounting profession.

This study has previously described the organization and activities of the AICPA which make it unfit to establish auditing and accounting standards in the public interest. Similarly, the "Big Eight" accounting firms have been shown to lack independence as auditors because of their involvement with the interests and business affairs of their big corporate clients. The SEC has nevertheless delegated to the AICPA, as the designated representative of the accounting profession, its responsibility under the Federal securities laws to determine the propriety of accounting standards.

The SEC summary states:

> The Federal securities laws and the Commission's rules, however, are consistent with the view that primary responsibility should rest with the accounting profession itself to audit registrants' financial statements *in accordance with the standards of the profession* and to report on whether the financial statements are presented in conformity with generally accepted accounting principles *established by the profession*. . . . The accounting standards or principles of the accounting profession, which are known as generally accepted accounting principles, have been promulgated by committees or boards *appointed or sponsored by the American Institute of Certified Public Accountants.* (Emphasis added.)

With respect to the FASB, the commission has repeated its decision to permit the AICPA to determine the public interest under the Federal securities laws:

> The FASB was created based on the recommendations of a study group established by the AICPA and chaired by former SEC Commissioner Francis M. Wheat. *That group*, after public hearings and considerable research, *concluded that accounting principles could best be set by a full-time body in the private sector.* (Emphasis added.)

The extraordinary degree to which the SEC has abdicated its responsibility to protect the public under the provisions of the Federal securities laws is evidenced by these statements. The SEC speaks of standards developed by the accounting profession, and conclusions reached by a private interest study group as to the best methods of setting accounting standards. No mention is made of the clear mandate expressed by Congress in the Federal securities laws that the public should be protected from false and misleading information. Congress vested the SEC with direct responsibility and authority to achieve that result. The Federal securities laws do not mention the AICPA, its predecessors, or the view that primary responsibility to determine proper accounting standards should rest with the accounting profession itself.

The SEC has failed to exercise the extensive powers given it by Congress. Instead, it has relied upon self-interested private groups to establish accounting standards that greatly affect the public, but are not designed to protect it. As a result, the public has suffered severe economic losses from the continuous use of accounting standards established by private interests which permit publicly-owned corporations to report financial information which may be false and misleading. This study includes materials describing the types of accounting abuses which have occurred. (See p. 188.)

Congress has found itself relying on questionable financial information as the basis for determining certain Federal policies. According to Professor Abraham J. Briloff, the SEC, along with the General Accounting Office, has failed to require that Lockheed Aircraft Corp. use prudent accounting standards. Professor Briloff states that accounting standards presently used by Lockheed with the tacit approval of the SEC result in misleading financial statements. The financial statements of Lockheed Aircraft Corp. are of special interest to the Federal Government because of the company's Federal loan guarantee. (See Appendix K, page 1605.)

For almost 40 years, the SEC has defended the accounting profession's authority to establish accounting standards. When Congress considered directing the SEC to establish uniform accounting standards for oil and gas companies, the SEC joined with the FASB and the AICPA in lobbying Congress to leave the establishment of such standards to the FASB. (See Appendix I, page 1437.) The views of the SEC were stated in its letter of 3 October, 1975:

> We believe strongly that the current standard-setting apparatus is a good one and should not be upset. Because the FASB is a recently created organization, care must be taken that its credibility is not eroded. We believe that a statutorily required governmental rulemaking procedure at this time to establish accounting standards by rule would seriously impair the effectiveness of the board.

The SEC stated its concern about actions by Congress which might threaten the FASB's authority, but did not express similar concern over the failure of the FASB and its predecessors to establish proper accounting standards for oil and gas companies during the past 40 years. Nor did the SEC comment on its own failure to establish such standards, or to require that they be established. The primary concern of the SEC has been to protect the privileged position of the AICPA and its standard-setting bodies, rather than to protect the public from improper accounting practices.

Finally, it should be noted that the SEC has chosen to rely upon the auditing standards established by the AICPA on behalf of the accounting profession, as well as the accounting standards which are established by the FASB. Although the SEC has no procedures designed to verify whether independent auditors are performing their duties properly, it opposed legislation which would have enabled the General Accounting Office to verify the accuracy of independent audits for oil and gas companies. (See Appendix I, page 1435.) The failure of the SEC to support verification of work performed by independent auditors is of special concern due to widespread revela-

tions of corporate wrongdoing which was not discovered by independent auditors.

Accounting Series Release 150

The SEC delegated its public authority and responsibility to private interests through issuance of Accounting Series Release No. 150. (See Appendix I, page 1433.) ASR 150, issued on 20 December, 1973, restated the SEC's basic policy of relying upon accounting standards developed in the private sector which have "substantial authoritative support." That policy was first stated by the SEC in 1938 through issuance of ASR 4. However, ASR 150 went one step further by specifically designating the AICPA-sponsored FASB as the official body in the private sector to establish accounting standards that are recognized by the SEC as having "substantial authoritative support."

A brief description of the process by which the SEC has come to rely upon the AICPA and FASB is included in this study at page 131. Professor Robert Chatov has provided a well-documented description of the SEC's reliance upon the private sector in his book, "Corporate Financial Reporting—Public or Private Control?" (See page 130.) Additional insights and illustrations are included by Professor Abraham J. Briloff in his two books, "Unaccountable Accounting" and "More Debits Than Credits." (See page 68.)

In ASR 150, the SEC attempted to justify its delegation of public authority to private interests by several statements which raise serious questions regarding the ability and resolve of the SEC to fulfill its responsibilities under the Federal securities laws. Those statements demonstrate an astounding willingness and determination by a Federal agency to rely upon the industries and professionals it regulates to establish public policies that significantly affect their financial status. The SEC has simply ignored the clearly apparent conflicts of interest, shown in this study, which are associated with the system of establishing accounting standards approved by the SEC.

The SEC chose to continue its policy of relying upon standard-setting bodies established by the AICPA, and concluded:

> The determinations by these bodies have been regarded by the Commission, with minor exceptions, as being responsive to the needs of investors.

Through the use of AICPA-developed accounting standards which the SEC believes have been responsive to the public, a vast array of abuses has occurred as a result of false and misleading financial statements that were reported to the public as accurate representations of corporate business activities. (See page 188.) Accounting standards established by the AICPA have permitted corporations to use any of several available alternative standards to account for the same type of business transaction. (See page 134.) Even the present chairman of the FASB, a former AICPA president, has recognized the failures of the AICPA's standard-setting efforts. (See page 168.)

In ASR 150, the SEC noted that the FASB was created upon the recommendation of an AICPA study group, and has been widely endorsed by industry, financial analysts, accounting educators, and practicing accountants. As described previously on page 133, that "broadly based study group" was carefully selected and financed by the AICPA,

which had an obvious self-interest in the study group's recommendations. It is not surprising that the study group recommended that establishment of accounting standards be left to the private sector under the AICPA-controlled FASB.

It is also not surprising that private business and accounting organizations which were permitted to join in the operation and sponsorship of the FASB have supported it. However, this study has shown that financial and organizational support for the FASB is narrowly concentrated among large corporations and their "Big Eight" auditors which primarily benefit from the present system of flexible, alternative accounting standards.

The SEC presented some remarkable reasons for endorsing the FASB. None of them supports the SEC's conclusion that the FASB will promote the interests of the public:

> The Commission endorsed the establishment of the FASB in the belief that the board would provide an institutional framework which will permit prompt and responsible actions flowing from research and consideration of varying viewpoints. The collective experience and expertise of the members of the FASB and the individuals and professional organizations supporting it are substantial. Equally important, the commitment of resources to the FASB is impressive evidence of the willingness and intention of the private sector to support the FASB in accomplishing its task. In view of these considerations, the Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB with the expectation that the body's conclusions will promote the interests of investors.

Although the FASB does provide an "institutional framework" for establishing accounting standards, the FASB organization and its decision-makers are drawn from, and controlled by, the AICPA and other self-interested private groups. FASB members do have substantial expertise and experience on accounting matters, and certain members of the sponsoring groups have contributed substantial financial resources to operating the FASB. However, their experience and resources are more than matched by their self-interest in the standards set by the FASB.

Experience, expertise, and financial resources are not the sole measures for determining the competence of an organization to establish accounting standards in the public interest. The most important measure of competence must be a valid claim to represent the public interest above all others. The AICPA-controlled FASB does not meet that test.

Finally, the SEC approved all past and future pronouncements by the FASB through the following statement in ASR 150:

> For purposes of this policy, principles, standards and practices promulgated by the FASB in its Statements and Interpretations will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered to have no such support.

The SEC thus established that accounting standards set by the FASB must be followed by all publicly-owned corporations, and that the standards set by this private organization, subject to minor exceptions, are the only standards which may be used.

Arthur Andersen & Co. has challenged the SEC's extraordinary delegation of authority to the FASB as an illegal avoidance of Federal administrative procedures. (See page 56.) In response, the SEC requested public comment on the charges made by Arthur Andersen & Co. (See Appendix I, page 1429.) The Arthur Andersen & Co. complaint recognizes ASR 150 for what it is—an attempt by a Federal agency to require the public to follow rules promulgated by a private organization without regard to procedural due process of law which is mandated by the Administrative Procedures Act.

Arthur Andersen & Co. sought a preliminary injunction in Federal court to prohibit the SEC from enforcing its accounting policies stated in ASR 150. In denying the injunction, the Federal District Court failed to recognize that the SEC, in approving accounting rules which have the force of law, has not satisfied proper procedural requirements. (See Appendix I, page 1547.) It may be necessary for Congress to exercise its legislative authority over the SEC to correct the adverse effects of the SEC's accounting policy stated in ASR 150.

Adverse Effects

Other adverse consequences of ASR 150 are:

> The FASB and the AICPA have full control over their rules of procedure, and there is no requirement that those rules protect the public. Previous case law indicates that the FASB and the AICPA cannot be sued by damaged parties for failing to adopt or follow proper rules of procedure because they are private organizations.
>
> There is no requirement, such as imposed on Federal advisory committees, that the FASB, the AICPA, or any of their task forces or committees be fairly balanced as to the views represented by their members, or that they deliberate in public session as multi-member Federal agencies and commissions must soon do under the "Sunshine" Act (P.L. 94–409.) This study shows that the FASB, the AICPA, their task forces, and committees are not balanced as to the views represented by their members, and that they do not meet in public.
>
> There is no process for assuring that members of the FAF, the FASB, and senior staff are suitable to establish accounting standards in the public interest. This study shows that almost all of those involved in the FASB organization are ill-suited to serve the public interest because of their business affiliations, their self-interests and their manner of selection.
>
> The SEC has essentially permitted the FASB's private sponsors to exercise all of the powers which are traditionally divided among three branches of Government. They exercise legislative authority through the FASB by establishing the standards they must follow. They exercise executive authority by applying accounting standards the FASB has established

to individual corporations. They are subject to no effective judicial review of their standards because the SEC has decreed in advance through ASR 150 that accounting standards established by the FASB are acceptable. Thus, the private sponsors of the FASB operate without effective checks and balances on their authority to establish and apply accounting standards.

The SEC presently attempts to influence auditing standards by threatening to act in certain areas if the AICPA does not issue its own standard first, and then withdraws when the AICPA issues a standard acceptable to the SEC. (See Appendix I, page 1444.) That is neither an efficient nor an appropriate method of regulation.

Relationship With the AICPA and the FASB

In keeping with its expressed determination to have the FASB establish accounting standards under the provisions of the Federal securities laws, the SEC described the mere oversight role it has reserved for itself in the summary of its responsibilities which was prepared for this subcommittee. (See Appendix I, p. 1450.) The SEC said:

> The Commission, through its chief accountant, has maintained oversight of the Financial Accounting Standards Board and its predecessor standard-setting bodies, with respect to the relationship between the work of these bodies and the Commission's responsibility to insure appropriate disclosure in financial statements filed pursuant to the Federal securities laws. This is accomplished by consultations and close liaison with the board on its ongoing projects and its deliberations on new projects. The Commission has noted with favor that the administrative procedures adopted by the board with respect to study and research, public hearings, and solicitation of comments on proposals in the process of development and issuance of accounting standards are similar to the procedures followed by the Commission in rulemaking.

The SEC's praise of the FASB's procedures fails to recognize the conflicts of interest involved with the FASB members who make the actual decisions on accounting standards. Certain of the FASB's procedures are questionable or inadequate. (See pages 147 and 165.) The insistent willingness of the SEC to delegate its authority to establish accounting standards to the private standard-setting bodies sponsored by the AICPA illustrates the close relationship which has developed between them.

The SEC appoints representatives from the AICPA and the "Big Eight" firms to important Federal advisory committees. For example, representatives from all of the "Big Eight" firms were appointed to the SEC's advisory committee on replacement cost data which will help develop guidelines for implementing that controversial reporting requirement. (See Appendix I, page 1445.) The SEC also appointed a partner in one "Big Eight" firm, and a former partner in another "Big Eight" firm, to its advisory committee on corporate disclosure.

An important factor in the SEC's close relationship with the AICPA and the FASB is that the chief accountants at the SEC have

long been members of the AICPA. The chief accountant of the SEC exercises great influence over its decisions and policies on accounting matters because of his administrative authority and his relationship with the SEC commissioners.

In addition to membership in the AICPA, the immediate past chief accountant of the SEC was employed as a consultant to Arthur Young & Co., one of the "Big Eight" firms, prior to accepting appointment to the top accounting position at the SEC.[1] His predecessor was the SEC's chief accountant for many years, and was hired as a consultant by the AICPA at an annual rate of $60,000 subsequent to his retirement from the SEC. (See Appendix E, page 924.) The present associate chief accountant of the SEC is also a member of the AICPA.

A close working relationship has developed with the AICPA and the FASB in order to help the SEC use its public authority to enforce auditing and accounting standards established by those private interest groups. When a Federal agency delegates its public authority to private interest groups, those groups necessarily become involved in the operations of the Federal Government.

Enforcement of Professional Standards

The SEC has broad authority to enforce proper standards of conduct for independent auditors because of the important public service function such auditors perform within the framework of the Federal securities laws. Congress specifically provided that independent auditors would assist the SEC in protecting the public by assuring that individual corporations were complying with accounting and reporting standards.

After receiving complaints that individual CPAs and small accounting firms are treated unfairly by the SEC, the subcommittee staff reviewed the SEC's procedures designed to ensure that independent auditors perform their responsibilities properly. The staff's review of SEC disciplinary proceedings against independent auditors since 1969 showed that individual CPAs and small accounting firms apparently were treated more harshly than large national accounting firms by the SEC. The subcommittee asked the SEC to explain its uneven application of enforcement sanctions. The SEC response raises questions about its disciplinary program. (See Appendix I, page 1467.)

The SEC response emphasizes that its primary enforcement procedure, a Rule 2(e) proceeding to determine the fitness of an independent auditor to practice before the SEC, is remedial rather than punitive in nature. Nevertheless, disciplinary sanctions against individual CPAs and small accounting firms have included public identification of the offending individuals, as well as permanent disqualification from practice before the SEC.

Offending individuals in large national accounting firms have not been identified to the public. Disciplinary sanctions usually have required only that external quality reviews[2] be conducted and, occasionally, a short temporary suspension from accepting new clients.

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[1] At the time this study was written, the SEC's chief accountant had just resigned to accept a position with the City of New York and no successor had been named.

[2] In a quality review, outside parties examine the internal policies and procedures of an accounting firm to determine whether those policies and procedures adequately assure that the firm's quality of practice will satisfy required standards.

The discrepancies in the SEC's disciplinary procedures are most apparent in regard to the three "Big Eight" firms which have been disciplined by the SEC—Arthur Andersen & Co., Peat, Marwick, Mitchell & Co., and Touche Ross & Co. None of the individual offenders was named, and the SEC agreed to the participation of CPAs from other large accounting firms in quality reviews, the results of which were kept confidential. The mild sanctions imposed by the SEC are especially significant because the SEC found that partners from Arthur Andersen & Co. and Peat, Marwick, Mitchell & Co. intentionally misled the SEC's staff in its investigations.[3]

Moreover, the SEC has continually relied on quality reviews conducted under the auspices of the AICPA, which is controlled by the "Big Eight" and other large national accounting firms. The AICPA also promulgates auditing and ethical standards which are recognized by the SEC. The SEC has essentially permitted the large national accounting firms to formulate the standards to which they should be held through the AICPA, and to participate in confidential quality reviews of one another to assure the SEC that they are performing their responsibilities adequately.

In its response to this subcommittee, the SEC defended its uneven application of disciplinary sanctions by saying that it would be unfair to punish innocent members of large accounting firms by imposing harsh sanctions. Similarly, the SEC said that it is unnecessary to name or discipline individuals in order to correct accounting abuses by large firms. The SEC stated that its methods provide "some assurance" that problems encountered in large accounting firms are corrected, and declined to identify individual offenders in past cases because they were not originally charged with violations.

The SEC's attitude toward disciplining large firms definitely benefits partners of such firms because they are held to a lesser degree of professional accountability. CPAs in large firms apparently need not fear professional damage or embarrassment from having their individual identities disclosed to the public in association with SEC disciplinary actions against their firms. Large firms also are apparently safe from losing the privilege to practice before the SEC because of the impact on innocent partners and clients. With no need to fear personal embarrassment or loss of their firm's privilege to practice, partners of large firms primarily risk only adverse publicity resulting from having their firm disciplined by the SEC.

There is, of course, no requirement that CPAs join large accounting firms, or that large firms must practice before the SEC. They apparently choose to do so because of the substantial financial benefits involved. They should then be prepared to accept the responsibilities that accompany those benefits. Because they are independent auditors for large corporations which have great impact on the public, CPAs in large firms should be held to standards of accountability that are at least as stringent as those imposed on individual CPAs and small accounting firms.

One major defect in the SEC's enforcement procedures is the lack of procedures to check periodically the work of independent auditors

[3] The texts of the SEC's disciplinary statements against these three firms are referenced in the sections describing each "Big Eight" firm individually. (See p. 54.)

for accuracy, competence, and thoroughness. At present, the SEC generally is able to act only after abuses and resulting damages have already occurred. Public confidence in the ability of independent auditors to perform their important responsibilities would undoubtedly be increased significantly by periodic quality reviews. Many accounting abuses could thus be avoided.

As described previously on page 114, quality review programs conducted by the AICPA and the "Big Eight" accounting firms are inadequate because of the obvious conflicts of interest involved. Periodic Federal quality inspections in such diverse areas as food and drug manufacturing and pollution control systems have proven to be useful and effective. Numerous abuses in auditing and accounting have caused extensive damage to the public, and demonstrate a real need for the SEC or another government agency to inspect periodically the work of independent auditors operating under the provisions of the Federal securities laws.

"Hochfelder" Decision

The United States Supreme Court adversely affected the opportunity for individuals to recover damages from errant accountants in *Ernst & Ernst* v. *Olga Hochfelder, et al.*, 96 Sup. Ct. 1375 (March 30, 1976). In that case, the Court held that "scienter"—the intent to deceive, manipulate, or defraud—is a necessary requirement of any private action for damages under the fraud provisions of the Federal securities laws. Thus, independent auditors are apparently liable to damaged individuals only when it can be proved that they intentionally performed a faulty audit or certified incorrect information. Independent auditors would not be liable for negligent or incomplete audits which result in damages to innocent investors relying upon certified corporate financial statements.

In his dissent to the *Hochfelder* decision, Justice Blackmun was joined by Justice Brennan in urging Congress to amend the Federal securities laws to permit damaged individuals to sue negligent accountants. Because the SEC had also taken the position that independent auditors should be liable for their negligence, this subcommittee requested the SEC to analyze the effect of the *Hochfelder* decision, and to recommend to Congress what legislative action was necessary to restore protection to investors from negligence by accountants. (See Appendix I, page 1479.)

After more than three months of consideration, the SEC responded to this subcommittee that it presently is unable to recommend what legislative action, if any, should be taken to achieve the reform thought necessary by Justices Blackmun and Brennan. (See Appendix I, page 1482.) The SEC's response does include a detailed analysis of existing cases which may be affected by the *Hochfelder* decision, as well as a copy of the decision itself.

It is important to establish the right of damaged individuals to sue accountants for negligence under the fraud provisions of the Federal securities laws. Private actions for damages have been instrumental in the enforcement and prevention of securities fraud, thus reducing the regulatory burden on the SEC while providing relief to those who deserve it. The SEC does not have the resources to detect and halt

negligence by independent auditors in most cases, and the SEC has no power to order reimbursement of individuals who have been damaged.

The SEC analysis of the *Hochfelder* decision suggests that it is unnecessary to restore private actions for damages because the SEC has other means to ensure that independent auditors perform adequately, most notably the Rule 2(e) proceedings previously described. (See page 180.) But Rule 2(e) proceedings do not order reimbursement of individuals who have been damaged. The SEC's close relationship with the AICPA and the large national accounting firms does not instill public confidence in the resolve of the SEC to police vigorously the practice of independent auditors. The SEC's record of mild disciplinary sanctions against large accounting firms indicates that the public should have a direct means under the Federal securities laws to hold independent auditors responsible for their negligence.

CHAPTER X. THE COST ACCOUNTING STANDARDS BOARD (CASB)

Congress created the Cost Accounting Standards Board, a Federal agency, in 1970 "to promulgate cost-accounting standards designed to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts." Approximately $20 billion of Federal defense contracts annually are subject to standards promulgated by the CASB, according to a summary of its statutory authority and powers which it prepared for this subcommittee. (See Appendix J, page 1563.)

The General Services Administration in its Federal Procurement Regulations has, as a matter of policy, extended the CASB's requirements to major negotiated contracts of civilian agencies. Thus, the impact of standards issued by the CASB spreads throughout the Federal Government on contracts aggregating far more than $20 billion annually, although no precise figure is available.

Decisions by the CASB significantly affect amounts charged to the Federal Government as "costs" by contractors. Private contractors seek to maximize amounts designated as "costs" under Federal contracts because it generally increases payments received from the Federal Government. Contract "costs" are often subject to escalation clauses as well. The CASB determines what are "costs" under Federal contracts.

The CASB establishes cost accounting standards in a manner which is essentially similar to the FASB's process for establishing financial accounting standards used in reporting the results of business activities to the public. Both have technical staffs and procedures to ensure that proposed standards are well-researched and subjected to public comment. Members of the CASB and the FASB exercise the same type of analysis in reaching decisions on accounting standards in their respective areas.

As stated in the CASB's 1976 Progress Report to the Congress:

> Accounting for the costs of Government contracts often deals with the same expenditures and the same problems of assigning costs to time periods as are of interest in financial and income tax accounting.

Organization and Resources

The composition and status of the CASB were specifically set forth in the legislation creating it. The Comptroller General of the United States, who heads the General Accounting Office, serves as the chairman of the five-member board. He appoints the other four members to four-year terms. Two of the appointed members must be from the accounting profession, with one being particularly knowledgeable about the cost accounting problems of small businesses. Of the remain-

ing two appointed members, one must be representative of industry, and the other must be from a department or agency of the Federal Government.

Although appointed by the Comptroller General, who is a Federal official, three of the five board members—a majority—are required by statute to be chosen from industry and the accounting profession. Members of the CASB serve part-time, so the three members from industry and the accounting profession retain their affiliations with the private interests they represent. The business activities of those members may be directly affected by standards promulgated by the CASB.

The procedures for selecting CASB members provide some assurance that the public interest will be represented in the decision-making process. The procedures for selecting FASB members provide no such assurance. However, the requirement that a majority of CASB members represent self-interested private groups raises serious questions concerning the CASB's ability to act truly on behalf of the public.

The CASB was established by statute as "an agent of the Congress . . . which shall be independent of the executive departments . . ." The board is delegated the legislative function of promulgating cost accounting standards "which shall have the full force and effect of law . . ."

Except for the extensive amount of time and technical complexities involved, Congress might very well have decided to legislate cost accounting standards directly. Were Congress to legislate accounting standards, they would be discussed and marked-up in open committee meetings, and passed in open session. The CASB meets privately, as does the FASB, to decide on accounting standards affecting the public. The new "sunshine" legislation (Public Law 94–409), which provides for open meetings of many multi-member Government agencies, does not affect the closed door policy of either the CASB or the FASB.

The CASB's 1976 Progress Report to the Congress states that the board has a staff of 37 full-time Government employees—24 professional and 13 administrative and clerical—and a fiscal 1976 budget of $1,457,000. The executive secretary of the CASB has told the subcommittee staff that the board is adequately staffed and funded, and that additional personnel and funds would not significantly aid the board in performing its functions. In contrast, the FASB staff is approximately twice as large as that of the CASB. The FASB's budget in 1975 was $3,415,437, or more than double the budget of the CASB.

Relationship With the FASB and Its Sponsors

The CASB maintains a close relationship with the FASB, the AICPA, and other FASB sponsors. During the past year, the CASB and its staff met several times with representatives of the FASB and its sponsoring groups. According to its report to Congress, the CASB meets with those groups to coordinate cost accounting standards with financial accounting standards established in the private sector. A list of the private groups and their representatives who meet with the CASB is included in Appendix J, p. 1566.

Members of the CASB and its professional staff belong to the AICPA and other private groups which sponsor the FASB. The two

CASB members from the accounting profession belong to the AICPA, and both are from "Big Eight" accounting firms. The CASB member from industry belongs to the Financial Executives Institute. Thirteen of the 24 professional staff members belong to the AICPA, and several are members of other private interest groups sponsoring the FASB. Biographies of CASB members and professional staff showing their affiliations with private organizations are included in its 1976 Progress Report to the Congress.

The CASB presented its Public Service Award to the AICPA in 1976 because of the work done by the AICPA's Cost Accounting Standards Board Committee. (See Appendix J, p. 1580.) As described previously, that committee is dominated by "Big Eight" accounting firms, and attempts to influence the CASB with their views. It is questionable whether the CASB needs to present public service awards in order to perform its responsibilities adequately. Such awards are certainly not needed to stimulate the efforts of a well-financed private organization which has a vested interest in influencing standards set by the CASB.

Standards

The board has a capable staff which provides in-depth research and analysis on subjects considered by the CASB. As of August 1976, it had established 14 cost accounting standards. They cover a variety of subjects, and most are responsive to the Federal Government's need for uniform and meaningful cost accounting standards. A description of the standards established by the CASB is included in its annual Progress Report to the Congress.

In two cases, the board showed a disturbing tendency to benefit private contractors with standards that depart from accepted concepts of "cost." The first was a proposal to compensate contractors for the purported effects of inflation. The Library of Congress projected that adoption of the proposal would result in increased charges to the Federal Government of $3–$6 million in fiscal 1976, increasing to an estimated additional $91–$130 million in fiscal year 1985. The defects in the CASB proposal were noted by the chairman of this subcommittee in his letter of comment on the proposal. (See Appendix J, p. 1581.) The proposal was ultimately withdrawn.

Secondly, the CASB adopted a standard (Cost Accounting Standard 414, "Cost of Money as an Element of the Cost of Facilities Capital") which permits contractors to charge the Federal Government as a "cost" for the return on capital used to build certain plant and facilities. Formerly, such "costs" were included in the determination of contract profits. This standard departs from the concept of "costs" used in reporting profits to the public. Thus, contractors are able to charge the Federal Government for a "cost" which is not used for determining income reported to investors, creditors, and other interested parties.

Another disturbing factor has been the CASB's recent consideration of increased exemptions from the requirements of following cost accounting standards established by the board. The board has broad authority to exempt government contractors from coverage of its rules, and is considering using a percentage of sales formula or similar method to liberalize its exemption policies. Adoption of such a proposal would impair the application of uniform cost accounting

standards to major contractors—the reason for which Congress created the CASB. Use of percentage of sales exemption standards by the Renegotiation Board has enabled many of the largest government contractors to escape provisions intended to protect taxpayers.

The fact that the CASB is successfully setting accounting standards with approximately half of the resources used by the FASB suggests that Federal agencies are capable of performing that task more efficiently than private organizations.

CHAPTER XI. EXAMPLES OF THE NEED FOR ACCOUNTING AND AUDITING REFORMS

This study refers to the failure of certain Federal agencies and private organizations to establish uniform and meaningful accounting standards. Failures in the process of auditing major corporations have also been noted. The scope of those failures is evident from the many specific examples which have been brought to public attention.

Professor Abraham Briloff described the serious accounting and auditing problems which have occurred during recent years in his statement and appendices presented before the Subcommittee on Oversight and Investigation of the House Committee on Interstate and Foreign Commerce on 21 May, 1976. (See Appendix K, p. 1609.) Appendix K includes other relevant materials.

Three accounting series releases issued by the SEC as notice of disciplinary settlements against Arthur Andersen & Co., Peat, Marwick, Mitchell & Co., and Touche Ross & Co. provide detailed descriptions of improper auditing by those firms. (See pages 56, 62, and 64.) Further insights are provided by relevant excerpts from the report of the trustee in bankruptcy for the Equity Funding Corp. (See Appendix C, p. 704.)

An article in the 23 February, 1976 issue of Time magazine summarized examples of bribes, kickbacks, and political payoffs by major corporations. (See Appendix K, p. 1754.)

Detailed information on disclosure of questionable activities by corporations is contained in the following three documents which may be obtained from their respective sources:

Securities and Exchange Commission, *Report of the SEC on Questionable & Illegal Corporate Payments and Practices*, submitted to the Senate Banking, Housing and Urban Affairs Committee, March 12, 1976.

House of Representatives, Subcommittee on Oversight and Investigations, Committee on Interstate and Foreign Commerce, Regulatory Reform—Securities and Exchange Commission, May 20, 21, 14, and June 1, 1976, 94th Congress, 2d Session (subcommittee print).

House of Representatives, staff study by the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce, *SEC Voluntary Compliance Program on Corporate Disclosure*, 94th Congress, 2d Session (subcommittee print, June 1976).

"Creative Accounting"

The term "creative accounting" is widely used to describe accepted accounting techniques which permit corporations to report financial results that may not accurately portray the substance of their business activities. Substantial financial losses and legal controversies have resulted from investments and loans predicated upon reported corporate "earnings" which were more apparent than real. Although "creative accounting" is recognized as a synonym for deceptive ac-

counting practices, Congress and the public are generally not familiar with specific accounting methods which fall within that category.

"Creative accounting" methods are noteworthy because they remain in use as generally accepted accounting principles, even though they have been shown to be deceptive in many cases. Their continued use and availability illustrate the failures of the existing system for establishing accounting standards, and contribute to public cynicism regarding the purpose and usefulness of financial statements.

In his statement before the House Subcommittee on Oversight and Investigation, cited above, Professor Briloff described a variety of "creative accounting" methods for reporting business transactions relating to leases, sales of products and services, capitalized interest, pensions, research and development costs, inventories, depreciation, business combinations, and exploration costs for natural resources. The following materials also describe examples of "creative accounting":

Percentage of completion.—The percentage of completion method for recognizing income enables companies to report income which has not actually been received. Professor Briloff described problems resulting from the use of this method of income recognition by Stirling Homex Corp. and Four Seasons Nursing Homes. Adm. H. G. Rickover, who heads the Naval Nuclear Propulsion Program (a joint project of the Navy Department and the Energy Research and Development Administration), has testified before Congress on the manner in which percentage of completion accounting distorts Navy shipbuilding contracts. (See Appendix K, p. 1721.)

Research and development.—In a letter to this subcommittee, Professor Briloff explained how Lockheed Aircraft Corp. has reported research and development costs as an asset which has permitted the company to remain financially solvent. (See Appendix K, p. 1605.)

Inventories and reserves.—Congressman William J. Hughes of New Jersey this year released a study showing how 14 of the Nation's 20 largest oil companies used accounting adjustments primarily relating to inventories and reserves in order to control their profits in 1974. (See Appendix K, p. 1755.)

Accounting for inflation.—The AICPA and certain "Big Eight" accounting firms have been promoting the concept of adjusting financial statements to reflect the purported results of inflation. On March 23, 1976, the SEC issued Accounting Series Release 190 ordering that large corporations estimate and report the purported effects of inflation on some financial accounts. The chairman of this subcommittee noted the defects in the SEC's rule in a letter opposing its adoption. (See Appendix I, p. 1440.) Professor Briloff described the general nature of inflation accounting in a letter to Congressman Charles Vanik of Ohio. (See Appendix K, p. 1697.)

Two proposals for reform of the accounting profession and its standards from within the profession are included in this study.

The first proposal, by Professor Briloff, was presented before the House Subcommittee on Oversight and Investigation. (See Appendix K, p. 1654.)

The second approach has been suggested by Eli Mason, managing partner of Mason & Company, a CPA firm headquartered in New York City. Mr. Mason is a past vice president of the AICPA, past president of the New York State Society of CPAs, and a current member of the New York State Board for Public Accountancy. (See Appendix K, p. 1747.)

APPENDIX A—QUESTIONNAIRE TO "BIG EIGHT" ACCOUNTING FIRMS AND RESPONSES

ABRAHAM RIBICOFF, CONN., CHAIRMAN

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United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

(Staff note: The same letter was sent to other "Big Eight" firms.)

19 December 1975

Mr. Walter Hanson
Managing Partner
Peat, Marwick, Mitchell & Company
345 Park Avenue
New York, New York 10022

Dear Mr. Hanson:

Much attention has recently been focused on the accounting profession and its procedures. Revelations of corporate wrongdoing have raised serious questions as to the quality and independence of outside auditors. Financial decisions and public policies are dependent upon the findings and procedures of accountants who determine the propriety of financial data and other information which are required by law to be disclosed.

This subcommittee is charged with ensuring that accounting practices used or approved by agencies of the Federal government are fair, accurate, and useful to those persons who must rely upon them. In particular, this subcommittee is concerned with the roles played by the General Accounting Office, the Securities and Exchange Commission, and the Cost Accounting Standards Board in promoting reliable accounting practices.

To a large degree, agencies of the Federal government have relied upon the findings and practices of the accounting industry in performing the duties assigned to them by Congress. The SEC has formalized this dependence in Accounting Series Release No. 150 which states that the Commission will generally respect and endorse the rulings of the Financial Accounting Standards Board - a body established and largely funded by the accounting profession to set accounting standards for the profession.

Unfortunately, very littie information is available to the public on accounting firms. In evaluating Federal accounting practices, it would be helpful to the subcommittee to have some basic information regarding the activities of accounting firms. A questionnaire seeking such information is enclosed.

As your firm is one of the largest and most influential accounting firms, I ask your cooperation in completing the questionnaire and returning it to the subcommittee as soon as possible.

Very truly yours,

Lee Metcalf

Enclosure

Reports, Accounting and Management Subcommittee

QUESTIONNAIRE

1. Please state the number of offices which your firm maintains within the United States (If more than one partnership, corporation or other entity exists in the United States, please furnish all names and answer subsequent questions accordingly.)

2. Please indicate the number of states, territories or possessions of the United States in which your firm maintains an office or affiliated office.

3. Please state the number of cities outside the United States in which your firm maintains offices or has an affiliation.

4. Please state the number of partners in your firm located in the United States (include only certified public accountants.)

5. Please state the number of principals located in your offices in the United States who are not certified public accountants.

6. Please state the total number of employees of your firm within the United States, excluding only partners and principals.

7. Please indicate the approximate percentage of total revenues for services performed by your firm in the following categories:

A. Auditing and accounting
B. Tax services
C. Management advisory services including executive, recruitment, product analysis, marketing analysis, and plant layout.
D. Actuarial services
E. Services performed for Federal, State or local governments
F. Other

8. Please state if your firm renders management or other advisory services in the following categories:

A. Executive recruitment
B. Marketing analysis
C. Plant layout
D. Product analysis
E. Actuarial services
F. Federal advisory committees

9. Please state the name and address of corporations listed on the New York Stock Exchange for which your firm is the independent auditor.

10. Please state the name and address of corporations listed on the American Stock Exchange for which your firm is the independent auditor.

11. Please state the number of other publicly-held corporations for which your firm is the independent auditor, and the number of privately held corporations for which your firm is the independent auditor.

12. Please indicate the total number of partners, principals and employees of your firm who are members of the American Institute of Certified Public Accountants.

13. Please state if your firm has made financial contributions, directly or indirectly, to the Financial Accounting Standards Board. If so, please indicate the amount of contributions made annually to date.

14. Please identify the departments, agencies or subdivisions of any federal, state, municipal or other government authority for which your firm performed any services during 1975.

15. Please identify the federal departments, agencies, subdivisions or authorities for which your firm has performed services during each year from Jan. 1, 1970 through Dec. 31, 1974.

16. Please state your firm's annual gross revenue from services performed for Federal departments, agencies, subdivisions or authorities during each year from Jan. 1, 1970 to Dec. 31, 1975.

17. Please state if your firm maintains a department, division or office for the procurement of Federal, State and local government contracts. If so, please indicate the name of the person(s) in charge of said department, division or office, and address of such office(s).

Mr. Walter Hanson
Peat, Marwick, Mitchell & Co.
345 Park Avenue
New York, N.Y. 10022

Mr. William Kanaga
Arthur Young & Company
277 Park Avenue
New York, N.Y. 10017

Mr. Michael Chetkovich
Haskins & Sells
1114 Avenue of the Americas
New York, N.Y. 10036

Mr. Richard T. Baker
Ernst & Ernst
1300 Union Commerce Building
Cleveland, Ohio 44101

Mr. John C. Biegler
Price Waterhouse & Co.
1251 Avenue of the Americas
New York, N.Y. 10020

Mr. Philip L. Defliese
Coopers & Lybrand
1251 Avenue of the Americas
New York, N.Y. 10020

Mr. Harvey Kapnick
Arthur Andersen & Co.
69 West Washington Street
Chicago, Illinois 60607

Mr. Russell E. Palmer
Touche Ross & Co.
1633 Broadway
New York, N.Y. 10019

ARTHUR ANDERSEN & CO.

69 WEST WASHINGTON STREET
CHICAGO, ILLINOIS 60602
(312) 346-6262

HARVEY KAPNICK
CHAIRMAN

January 7, 1976

Honorable Lee Metcalf, Chairman
Subcommittee on Reports, Accounting,
and Management
Committee on Government Operations
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

On December 29, we received your letter of December 19, 1975, and the questionnaire requesting certain information on our firm. We are in the process of assembling this information for submission to your Subcommittee.

In your letter, you noted that "very little information is available to the public on accounting firms" and that serious questions have recently been raised as to "the quality and independence of outside auditors." In an effort to meet our public interest responsibility and so that interested parties would have information with regard to our firm and the control we have over our professional practice, we have prepared annual reports for each of our past three fiscal years for distribution to our personnel, clients and others. Copies of these reports are enclosed together with copies of charts (prepared for our internal purposes) showing information on the independent auditors for companies listed on the New York and American Stock Exchanges. These may be of some immediate assistance to your Subcommittee.

In 1974, our firm established an independent Public Review Board to review our operations on a complete and continuing basis. The Public Review Board's first report to our firm is included, in its entirety, beginning on page 32 of the enclosed annual report for our fiscal year ended August 31, 1975. In addition, this same annual report contains a section pertaining to our programs and policies for the quality control of our professional practice (beginning on page 23) which may be helpful to your Subcommittee.

If we can be of further assistance to you, please do not hesitate to contact me, Mr. Charles A. Bowsher, a partner

ARTHUR ANDERSEN & CO.

Honorable Lee Metcalf
January 7, 1976
Page 2

in our Washington, D. C. office who is the Director of our Federal Government Liaison group, or Mr. G. E. Stanton, our Vice Chairman-Administration, who will be sending you the requested information on our firm.

Very truly yours,

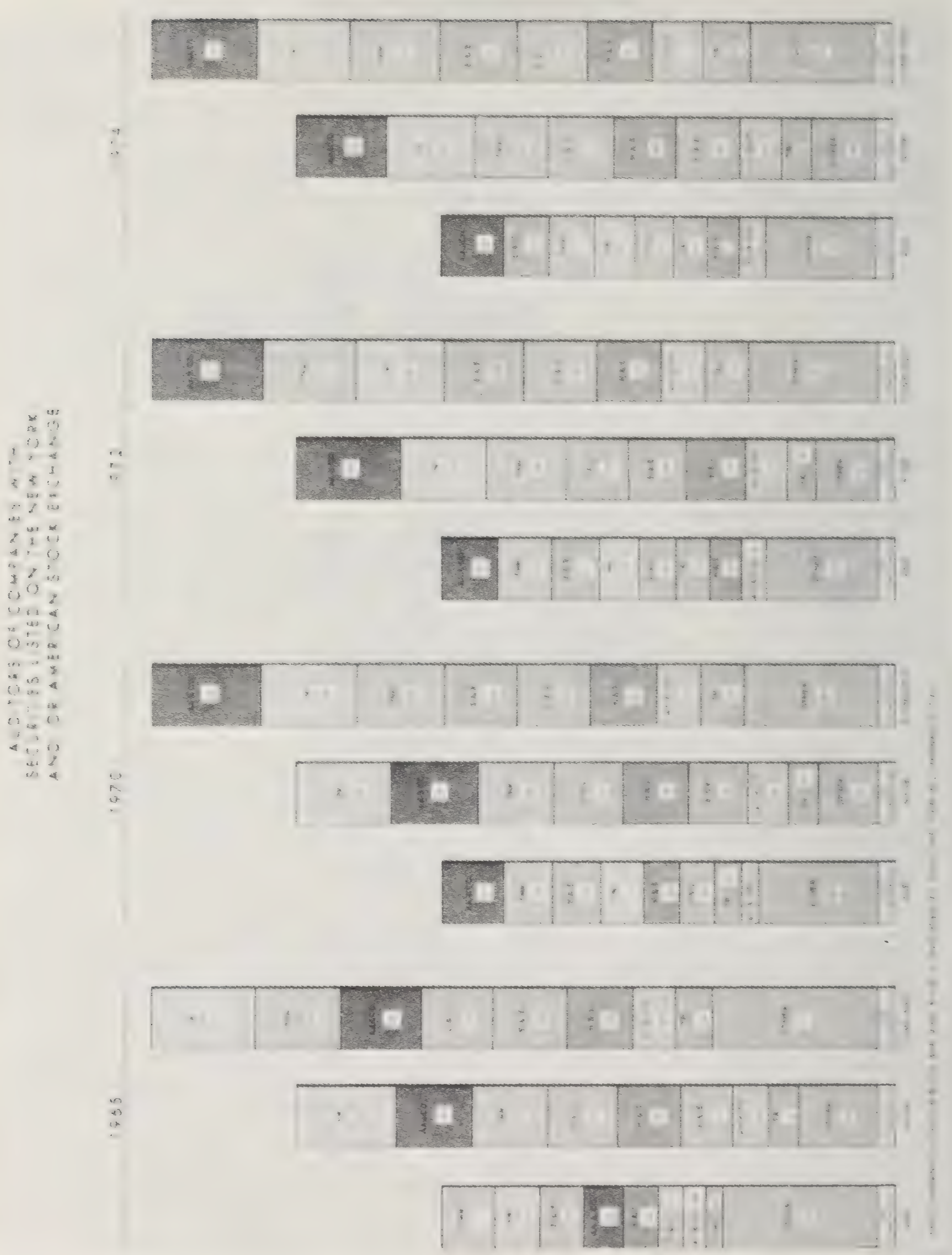
Harvey Kapnick

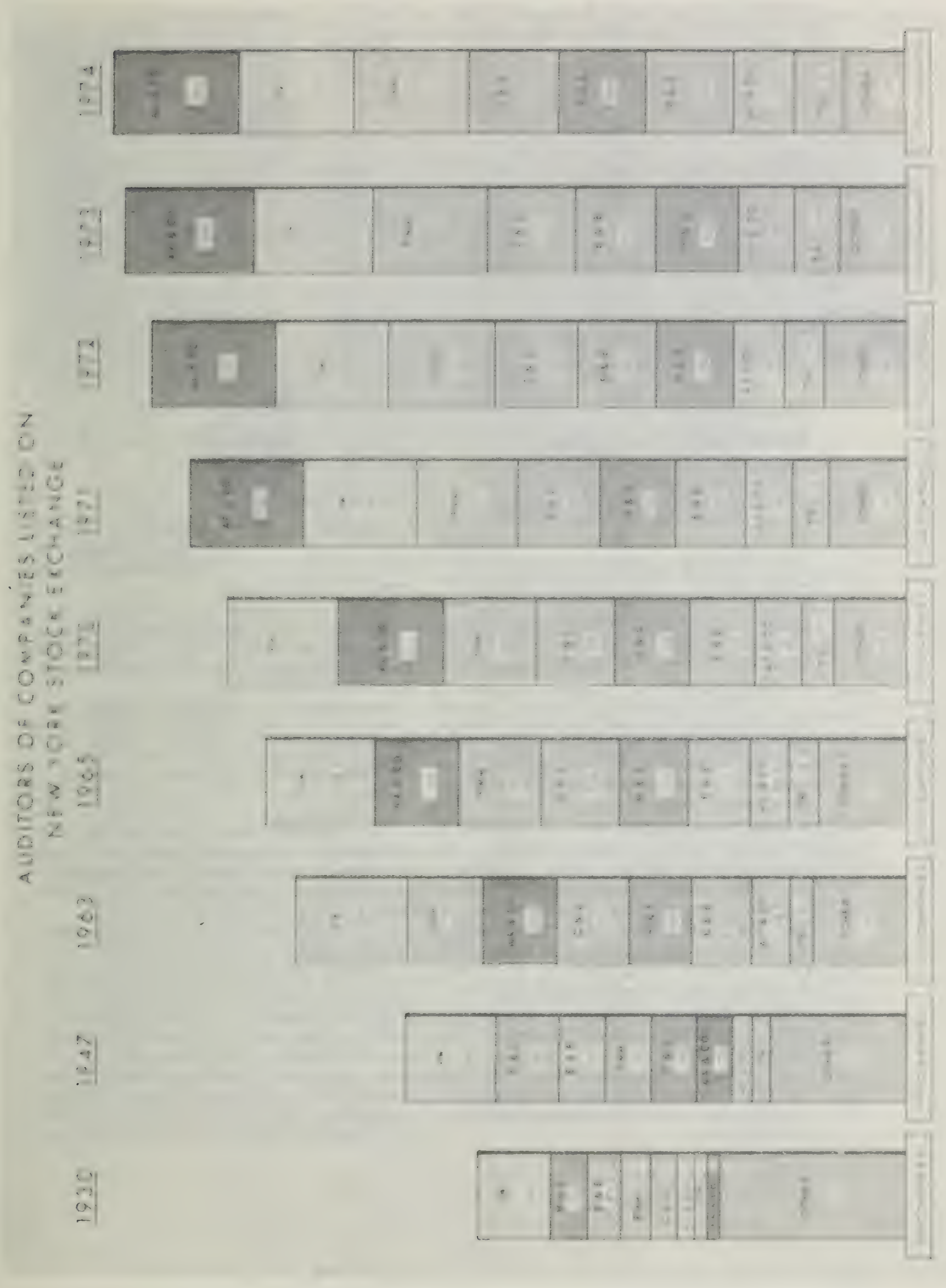
Enclosures

Copy and enclosures to:

Senator John L. McClellan
Senator Edmund S. Muskie
Senator Sam Nunn
Senator John Glenn
Senator Bill Brock
Senator Charles H. Percy
Senator Lowell P. Weicker, Jr.

Mr. Vic Reinemer, Staff Director
Mr. E. Winslow Turner, Chief Counsel

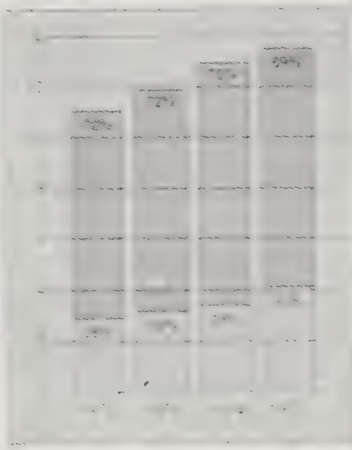

AUDITORS OF COMPANIES WITH SECURITIES LISTED ON THE NEW YORK AND OR AMERICAN STOCK EXCHANGE
1965
1970


AUDITORS OF COMPANIES LISTED ON
NEW YORK STOCK EXCHANGE

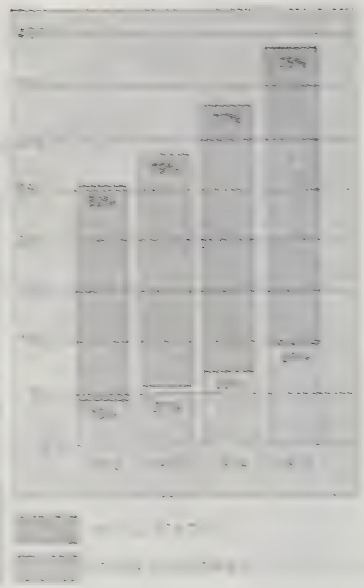
Excerpt from Arthur Andersen & Co.'s Aug. 31, 1975 "Annual Report to our Worldwide Organization."

Left. Barrett Crawford, Director—Finance, with G E Stanton, Vice Chairman—Administration

TOTAL PERSONNEL *in Thousands at August 31*



FEES *in Millions of Dollars*



Worldwide Financial Review

Combined Financial Statements

In our 1973 and 1974 Annual Reports we included summaries of combined financial information on the Arthur Andersen Worldwide Organization. This year we have included conventional financial statements and accompanying notes prepared in accordance with generally accepted accounting principles. Summary financial data which illustrate some of the effects of inflation are shown on page 21.

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The accompanying combined financial statements have not been audited by another firm of independent public accountants. However, in addition to periodic internal audit procedures under the supervision of the Director—Finance, these financial statements were subjected to an external-type audit by a team of audit partners, managers and staffmembers who were not associated with the operations subject to their examination. The scope of the external-type audit was reviewed with the Audit Committee of the Public Review Board and was comparable in all respects to the scope of audit we follow in auditing client financial statements. Because it lacks independence, the audit team which conducted the external-type audit is not in a position to express an opinion on the combined financial statements.

The firm changed its fiscal year from March 31 to August 31 in 1974. Accordingly, all accompanying financial data are presented on an August 31 basis.

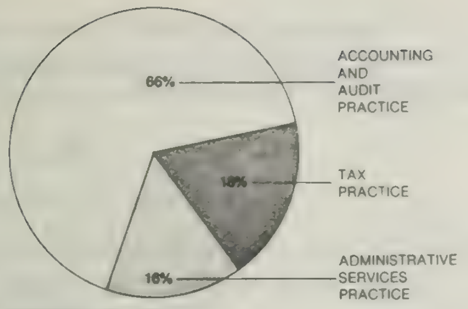
Operating Results

Considering the business recession and adverse economic climate in many countries during the past year, the worldwide operating results in fiscal 1975 were very good.

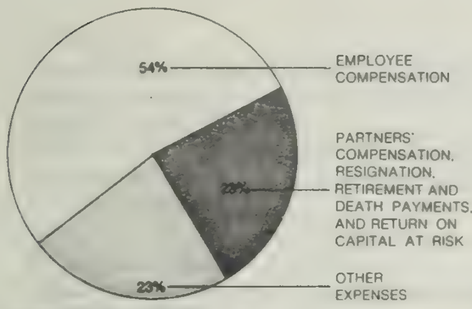
	Year Ended August 31		Percent
	1975	1974	Increase
Fees for professional services	$386,341,000	$332,786,000	16.1%
Expenses—			
Employee compensation	208,283,000	178,924,000	16.4
Other	87,240,000	74,266,000	17.5
Earnings for the year	90,818,000	79,596,000	14.1
Average earnings per partner active at year-end	95,152	90,550	5.1

The percentage of worldwide fees contributed by operations outside the United States continued its upward trend. During fiscal 1975 it was 24.8%; this compares with 22.7% in 1974, 20.5% in 1973 and 18.3% in 1972.

Approximately 30% of the $53.6 million increase in worldwide fees in fiscal 1975 was due to a 4.5% growth in hours of client service (2.8% in the United States and 9.0% in all other countries). The remainder of this increase was due to higher average hourly billing rates (approximately 8.5% in the United States and 14.7% in all other countries). Billing rate increases were necessary to cover increased employee compensation levels and other expenses. Due to inflation, employee compensation in some countries



SOURCE OF 1975 WORLDWIDE FEES



DISPOSITION OF 1975 WORLDWIDE FEES

William Ingersoll, Firm Treasurer, with George Bunge, Director—Firm Taxes, and Betty Brons, receptionist

Left: Philip Keirn, Director—Systems and Computer Operations—U.S., with Frank Monhart, Firm Controller

was adjusted more frequently than once a year. In several countries, such adjustments were required to be based upon changes in a government price index.

During 1975, we incurred costs aggregating \$29,571,000 (including \$655,000 of interest expense and \$10,855,000 of other nonpayroll expenses) in direct training of our professional personnel. This amounts to approximately 8% of fees. Research and quality control costs incurred in 1975 were \$11,520,000 (including \$4,626,000 of nonpayroll expenses), or 3% of fees.

The participants in worldwide earnings in fiscal 1975 included 844 partners, participating principals, non-United States principals and overseas representatives active as of August 31, 1975, and 132 resigned and retired partners and estates of deceased partners. As indicated in the Combined Statement of Earnings, the compensation of partners for their services is not shown as an operating expense. Therefore, earnings for the year are not profit to the partners. Rather, they represent the amount available to cover partners' current compensation, resignation, retirement and death payments and return on capital at risk. Furthermore, each partner must personally pay for retirement and fringe benefits. After providing for such items, partner earnings must be at a level to attract and retain partners with the professional competence essential to the firm.

Financial Position

As shown below, with over \$100 million of partners' capital and with long-term debt representing only 20% of total capitalization as of August 31, 1975, the firm's capital structure continues to be sound:

	August 31		
	1975	1974	Increase
Working capital	\$ 88,864,000	\$ 87,534,000	\$1,330,000
Net property and equipment	36,722,000	32,063,000	4,659,000
	\$125,586,000	\$119,597,000	\$5,989,000
Less—Long-term debt	24,973,000	26,475,000	(1,502,000)
Partners' capital	\$100,613,000	\$ 93,122,000	\$7,491,000

Net additions to property and equipment were \$10,049,000 in 1975 and \$8,483,000 in 1974. Offices which made major moves or additions to their office space during fiscal 1975 included Chicago, Hartford, Houston, London and Paris.

The average paid-in and pro forma capital per partner active as of August 31, 1975, was \$96,000.

Arthur Andersen Worldwide Organization

Combined Statement of Financial Position (Note 1)

August 31, 1975 and 1974 (not audited by independent accountants)

ASSETS	1975	1974
	(in thousands)	
Current Assets:		
Cash	$ 20,631	$ 18,377
Receivables from clients, less allowances of $4,930 in 1975 and $4,154 in 1974 for uncollectible accounts	52,157	51,104
Unbilled services at estimated billable amounts	45,605	45,765
Other current assets	6,022	4,975
Total current assets	$124,415	$120,221
Property and Equipment, at cost (Notes 1 and 7):		
Center for Professional Development—		
Land, buildings and equipment	$ 11,373	$ 11,062
Less—Accumulated depreciation	2,180	1,416
	$ 9,193	$ 9,646
Offices—		
Land and buildings	$ 4,313	$ 4,304
Leasehold improvements	15,889	12,821
Furniture and equipment	24,376	21,056
	$ 44,578	$ 38,181
Less—Accumulated depreciation and amortization	17,049	15,764
	$ 27,529	$ 22,417
Net property and equipment	$ 36,722	$ 32,063
	$161,137	$152,284

LIABILITIES AND PARTNERS' CAPITAL

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	1975	1974
Current Liabilities:		
Notes payable to banks (Note 2)	$ 1,269	$ 756
Current portion of long-term debt	1,538	1,463
Accounts payable	5,403	6,618
Accrued payroll, withholdings and fringe benefits	20,699	18,738
Accrued taxes (Note 1)	3,258	2,559
Other accrued liabilities (Note 8)	3,384	2,553
Total current liabilities	$ 35,551	$ 32,687
Long-term Debt (Note 2)	$ 24,973	$ 26,475
Partners' Capital (Notes 1, 3 and 8):		
Paid-in capital	$ 42,197	$ 42,965
Pro forma capital	54,535	54,145
Undistributed cash earnings	3,881	(3,988)
Total partners' capital	$100,613	$ 93,122
	$161,137	$152,284

The accompanying notes are an integral part of this statement.

Arthur Andersen Worldwide Organization
Combined Statement of Earnings (Note 1)
for the Years Ended August 31, 1975 and 1974 (not audited by independent accountants)

	1975	1974	
	(in thousands)		
Fees for Professional Services	$386,341	$332,786	
Expenses (not including partner compensation):			
Employee compensation and fringe benefits—			
Managers	$ 58,367	$ 48,854	
Professional staff	121,506	105,839	
Office support group	28,410	24,231	
	$208,283	$178,924	
Other expenses—			
Occupancy (including depreciation and amortization)	$ 22,300	$ 18,964	
Training (including depreciation on Center for Professional Development)	10,855	8,909	
Research and quality control	4,626	3,322	
Personnel transfers and expatriate allowances	5,926	4,883	
Professional indemnity insurance and litigation	4,992	4,600	
Practice development	4,042	3,321	
Provision for uncollectible accounts	3,925	3,102	
Professional and office supplies	3,861	3,213	
Contributions to nonprofit organizations and civic activities	2,671	2,472	
Telephone, telex and postage, net	2,126	2,127	
Recruiting professional personnel	1,510	1,698	
Professional society activities and dues	1,525	1,445	
Management and annual partners' meetings	1,106	1,830	
Foreign currency translation and exchange losses, net (Note 1)	1,089	366	
Interest, net	1,708	1,723	
Entity income and business taxes (Note 1)	3,568	1,749	
Other	11,410	10,542	
	$ 87,240	$ 74,266	15
Total expenses	$295,523	$253,190	
Earnings for the Year (Note 1)	$ 90,818	$ 79,596	
Allocation of Earnings (Notes 3 and 5):			
To active partners—			
Resigned, retired and deceased partners to date of resignation, retirement or death	$ 4,785	$ 2,255	
Partners active at year-end	80,308	73,708	
To resigned and retired partners and estates of deceased partners—			
Retirement and supplementary payments	4,726	3,178	
Not allocated to partners—retained for specific partnership purposes	999	455	
	$ 90,818	$ 79,596	
Number of partners active at year-end (weighted in 1974 for change of fiscal year)	844	814	
Average earnings per partner active at year-end	$ 95,152	$ 90,550	

The accompanying notes are an integral part of this statement.

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Arthur Andersen Worldwide Organization

Combined Statement of Source and Disposition of Working Capital (Note 1)
for the Years Ended August 31, 1975 and 1974 (not audited by independent accountants)

	1975	1974
	(in thousands)	
Source of Working Capital:		
Earnings for the year	$90,818	$79,596
Depreciation and amortization—not requiring an outlay of working capital	5,390	4,639
	$96,208	$84,235
Capital paid in by partners (Note 3)	2,326	4,941
Additional long-term debt	—	2,000
Net proceeds from sale of office building	—	196
Total	$98,534	$91,372
Disposition of Working Capital:		
Distribution of cash earnings	$82,559	$78,049
Repayment of paid-in capital to resigned and retired partners and estates of deceased partners	3,094	893
Net additions to property and equipment—		
Center for Professional Development	311	2,344
Offices	9,738	6,139
Reduction of long-term debt	1,502	1,817
Total	$97,204	$89,242
Increase In Working Capital (Note 6)	$ 1,330	$ 2,130
Working Capital—Beginning of Year	87,534	85,404
Working Capital—End of Year	$88,864	$87,534

Combined Statement of Changes in Partners' Capital (Note 1)
for the Years Ended August 31, 1975 and 1974 (not audited by independent accountants)

	1975	1974
	(in thousands)	
Paid-in Capital (Note 3):		
Balance, beginning of year	$42,965	$38,917
Capital paid in by partners	2,326	4,941
Repayment of paid-in capital to resigned and retired partners and estates of deceased partners	(3,094)	(893)
Balance, end of year	$42,197	$42,965
Pro Forma Capital (Note 3):		
Balance, beginning of year	$54,145	$45,904
Cash earnings for the year	$90,428	$71,355
Memorandum adjustments to reflect accrual basis of accounting, net (Note 1)	390	8,241
Earnings for the year	$90,818	$79,596
Cash earnings for the year transferred to undistributed cash earnings	(90,428)	(71,355)
Balance, end of year	$54,535	$54,145
Undistributed Cash Earnings (Note 3):		
Balance, beginning of year	$ (3,988)	$ 2,706
Cash earnings for the year	90,428	71,355
Distribution of cash earnings	(82,559)	(78,049)
Balance, end of year	$ 3,881	$ (3,988)

The accompanying notes are an integral part of these statements.

Arthur Andersen Worldwide Organization
Notes to Combined Financial Statements
August 31, 1975 and 1974 (not audited by independent accountants)

(1) Summary of Significant Accounting Policies:

Basis for Presentation of Financial Statements—

The accompanying financial statements include the combined accounts of the worldwide organization of Arthur Andersen (the firm) which includes Arthur Andersen & Co. (an Illinois partnership), separate legal entities with the Arthur Andersen name and organizations with which Arthur Andersen & Co. has exclusive representation agreements, all of which are authorized under the laws of the countries in which such operations are located. Within this worldwide organization there are partners, participating principals, non-United States principals, and overseas representatives (collectively referred to herein as "partners").

Except as required by the laws of certain countries, the Illinois partnership and related worldwide organization entities maintain books and records and file income tax returns on the cash basis of accounting. Distributions to partners are determined on the cash basis of accounting. The accompanying combined financial statements have been prepared in accordance with generally accepted accounting principles on the accrual basis of accounting by combining cash basis accounting records with memorandum adjustments to include receivables for billed and unbilled services, accounts payable, accrued liabilities, etc.

Translation of Foreign Currencies—

Assets and liabilities of all non-U.S. entities, except for property and related depreciation accounts, have been translated into U.S. dollars at rates of exchange in effect at year-end. Property and depreciation accounts have been translated at rates of exchange in effect at acquisition dates. Fees and expenses, other than depreciation, are translated at average exchange rates in effect during the year. Gains and losses (a net loss of $1,090,000 in 1975 and $182,000 in 1974) on the translation of foreign currencies to U.S. dollars are recorded currently in earnings.

Revenue Recognition—

Fees for professional services in the accompanying financial statements are recognized at the time such services are rendered, at estimated billable amounts.

Training, Research and Quality Control—

All training, research and quality control costs are charged to expense as incurred.

Property and Depreciation—

Generally, depreciation on property and equipment and amortization of leasehold improvements are computed by use of the following methods and lives:

	Method	Life in Years
Land improvements	Declining balance	10
Buildings	Straight line	19 to 37
Furniture and equipment	Double declining balance	6 to 12
Leasehold improvements	Straight line	Term of lease

Maintenance and repairs are charged to expense as incurred and major replacements and improvements are capitalized. The cost and accumulated depreciation of items sold, retired, or fully depreciated are removed from the property accounts and any resultant gain or loss is recorded currently in earnings.

Income Taxes—

Since partnerships in most countries are not taxable as entities, substantially all taxes on earnings are paid by the partners on the basis of their individual income tax returns. The accompanying combined statement of earnings includes provisions of $2,800,000 in 1975 and $1,300,000 in 1974 for income taxes of certain non-U.S. entities which are taxed as entities. Earnings of certain such non-U.S. entities are required to be reported on a basis different for tax purposes than for accounting purposes. Deferred non-U.S. entity income taxes (not material in amount) have been provided to reflect the tax effect of such timing differences.

Earnings for the Year—

Earnings for the year are not comparable to the net income of a corporation and are not profit to the partners. Rather, they represent the amount available to cover partners' current compensation, resignation, retirement and death payments and return on capital at risk. Each partner must personally pay for retirement and fringe benefits.

Change of Fiscal Year—

The firm changed its fiscal year from March 31 to August 31 in 1974. Accordingly, all accompanying financial data are presented on an August 31 basis. Certain reclassifications have been made in 1974 to conform previously reported data to the 1975 format.

(2) Financing Arrangements:

Long-term debt as of August 31, 1975 and 1974, consisted of the following (in thousands):

	1975	1974
Notes payable to a nonclient insurance company—		
Unsecured note, payable $1,326,000 semiannually to 1985, including interest at 7¼%	$18,525	$19,767
Unsecured note, payable $141,000 semiannually to 1986, including interest at 9½%	1,905	2,000
Mortgage note, payable $110,000 semiannually to 1985 and $1,436,000 semiannually in 1986, including interest at 7¼% (collateralized by office building in Los Angeles)	2,993	2,995
Purchase mortgage note, payable $406,000 annually to 1990, including interest at 10% (collateralized by Center for Professional Development).	3,088	3,176
	$26,511	$27,938
Less—Current portion	1,538	1,463
Long-term debt	$24,973	$26,475

Arthur Andersen Worldwide Organization
Notes to Combined Financial Statements
August 31, 1975 and 1974 (not audited by independent accountants)

The terms of the unsecured long-term note agreements provide, among other things, that the firm will not make any distributions of earnings to any of its partners or undertake certain other restricted transactions unless prior to and immediately after such distribution or transaction, net current assets will not be less than two times funded debt (as defined) and net assets will not be less than one and one-quarter times funded debt. As of August 31, 1975, both net current assets and net assets were in excess of three and one-quarter times funded debt. The terms of these agreements also provide that the firm may request additional unsecured borrowings of $2 million in 1976 and 1978, and in 1980 not less than $4 million (either in a lump sum or in installments between 1980 and 1985) at ½% over the prime interest rate. If such requests are not granted, the firm may obtain such funds from other lenders in 1976 and 1978 and may prepay the entire loan balance without penalty and negotiate with other lenders in 1980.

The maturities of long-term debt through 1980 are as follows (in thousands):

1976	$1,538
1977	1,656
1978	1,784
1979	1,921
1980	2,070

A $15 million line of credit at the prime interest rate has been arranged with a nonclient bank to cover temporary unforeseen conditions and to allow time to effect a proper rearrangement of the firm's capital structure. This line requires the firm to maintain an average deposit balance of 10% of the line or 20% of the outstanding loan, whichever is greater. No amounts were borrowed under this line of credit during 1975 or 1974.

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The firm also has lines of credit of approximately $4 million (principally overdraft arrangements) with several nonclient banks for use in countries outside the United States, primarily to cover local peak working capital requirements and to hedge against currency exchange rate fluctuations. Borrowings under these lines of credit averaged $1,352,000 in 1975 and $921,000 in 1974 at average interest rates of 12.3% and 12.7%. Maximum borrowings under these lines were $1,878,000 in 1975 and $1,251,000 in 1974.

(3) Partners' Capital:

No partner has in excess of ½ of 1% of partners' capital or participation in earnings for the year.

Partners' capital as of August 31, 1975 and 1974, consisted of the following (in thousands):

	1975	1974
Paid-in Capital—		
Paid-in capital	$42,197	$42,965

Partners were admitted to the firm on April 1, 1974, prior to the change of fiscal year, and again on September 1, 1975.

Paid-in capital as of August 31, 1975, includes $2,326,000 paid in by new partners admitted to the firm on September 1, 1975, and by existing partners for additional units of participation effective September 1, 1975. Additional paid-in capital of $2,708,000, receivable from partners as of September 1, 1975, was not recorded as of August 31, 1975. Paid-in capital is repayable within sixty days following a partner's resignation, retirement or death. No amounts are paid in or returned to partners for goodwill or appreciation of assets; thus, partners do not realize any appreciation on their paid-in capital.

Pro Forma Capital—	1975	1974
Allocated to partners	$43,396	$44,005
Not allocated to partners—retained for specific partnership purposes (partner retirement and supplementary payments [Note 5] and uninsured risks [Note 8])	11,139	10,140
	$54,535	$54,145

Pro forma capital allocated to partners is equal to their share of uncollected receivables from clients and unbilled services, less accounts payable, accrued liabilities, etc., not allocated for specific partnership purposes. Pro forma capital is payable at various dates after a partner's resignation, retirement, or death.

Undistributed Cash Earnings—	1975	1974
Cash distributions to partners in excess of cash earnings for the five months ended August 31, 1974 (date of change in fiscal year; repaid in December, 1974)	$ —	$(3,988)
Fiscal 1975 undistributed cash earnings paid in October, 1975	3,881	—
	$3,881	$(3,988)

(4) Employee Profit-Sharing and Pension Plans:

The firm has a trusteed profit-sharing plan for substantially all employees in the United States and Puerto Rico. The minimum annual contribution to the profit-sharing trust is based on the firm's earnings as defined in the plan. The provision for profit-sharing was $2,820,000 in 1975 and $2,469,000 in 1974. The payment to the profit-sharing trust in 1975 was $3,263,000 which was 5% of members' compensation, the maximum amount contributable under the terms of the plan.

The firm also has a noncontributory pension plan for employees in the United States and Puerto Rico. The provision for pension expense was $749,000 in 1975 and $559,000 in 1974, which includes the amortization of unfunded past-service costs over ten years. As of April 1, 1975 (date of latest actuarial valuation), the unfunded past-service liability was $1,675,000 including $965,000 of actuarially computed vested benefits in excess of pension fund assets.

The United States Employee Retirement Income Security Act of 1974 requires the firm to amend the above plans to conform with certain provisions of the Act which will become effective in 1976. Management believes that the effect of these changes on annual profit-sharing and pension costs, the funding of such costs for 1976 and subsequent years and unfunded vested benefits will not be significant.

The firm also has profit-sharing, pension or similar government-sponsored plans for employees in other countries. It is the firm's policy to fund profit-sharing and pension costs.

(5) Partner Resignation, Retirement, and Death Payments:

The partners have agreed that all eligible partners will participate in the United States Partners' and Participating Principals' Profit Sharing Plan (Keogh Plan) or equivalent plans outside the United States. Annual contributions of individual partner earnings are required to be made to a trust under the Keogh Plan or to equivalent plans in the amount of 5% of the participant's cash earnings or $5,000, whichever is less. Funds in such plans are administered by a committee of partners and benefits are paid from the trusts.

In addition, partners participate in the earnings of the firm after resignation, retirement, or death. Retirement payments are made to retired partners and the estates of deceased partners. Such payments were made at the rate of $10,800 annually in 1975 and $9,975 in 1974, commencing at mandatory retirement age (changed from age 65 to 62 effective July 1, 1974) in monthly installments for life or for ten years certain in case of death. Such payments may begin at an earlier age at reduced amounts. The amounts payable are adjusted annually based upon a price index. Such payments aggregated $868,000 in 1975 and $325,000 in 1974 to retired partners, to estates of deceased partners, and to resigned partners who resigned after age 50 with 20 years of service. In general, such resigned partners receive discounted lump-sum settlements at the time of resignation. An actuarial determination of amounts payable to partners as of August 31, 1975 (in process of amortization over 30 years) was approximately $17,000,000, of which approximately $6,500,000 was applicable to partners already retired. These retirement payments can be rescinded or revoked at any time by a two-thirds vote of the partners.

For partners as of July 1, 1974 (the effective date of adopting the mandatory Keogh-type plans), certain supplementary amounts are payable upon resignation or retirement and to estates of deceased partners based upon years as a partner and an age/discount formula to July 1, 1974. No amounts are payable to partners admitted after July 1, 1974. Unpaid amounts are increased by interest at 5% per annum. As of August 31, 1975, the aggregate amount payable was $41,790,000, including interest to that date, and is being allocated from annual earnings over a ten-year period ending in 1984. Payments of such amounts were $4,332,000 in 1975 and $529,000 in 1974, including $1,181,000 in 1975 and $331,000 in 1974 to the Keogh-type plans on behalf of certain active partners.

Payments and allocations of earnings for partner retirement and supplementary payments aggregated $6,700,000 in 1975 ($4,520,000 to resigned and retired partners and estates of deceased partners, $1,181,000 to certain active partners for Keogh or equivalent plan contributions, and $999,000 allocated to pro forma capital for future retirement and supplementary payments).

(6) Changes in Working Capital:

Combined Statement of Financial Position increases (decreases) which increased working capital to $88,864,000 and $87,534,000 as of August 31, 1975 and 1974, were as follows (in thousands):

	1975	1974
Current assets—		
Cash	$2,254	$(4,829)
Receivables from clients, net	1,053	11,542
Unbilled services	(160)	(4,004)
Other current assets	1,047	(1,016)
	$4,194	$ 1,693
Current liabilities—		
Notes payable to banks and current portion of long-term debt	$ 588	$ 627
Accounts payable	(1,215)	(30)
Accrued payroll, withholdings and fringe benefits	1,961	232
Other	1,530	(1,266)
	$2,864	$ (437)
Increase in working capital	$1,330	$ 2,130

(7) Lease Commitments:

The firm has various lease agreements, principally for office space. Rental expense was $16,532,000 in 1975 and $13,655,000 in 1974. In most cases, such payments include insurance, normal maintenance, etc. As of August 31, 1975, commitments under these leases, excluding expense escalation provisions, aggregated $148,552,000 which is payable as follows (in thousands):

1976	$ 16,015
1977	15,341
1978	14,130
1979	12,994
1980	12,115
1981–1985	46,917
1986–1990	19,546
1991–1995	9,611
1996–2020	1,883
	$148,552

The present value of these payments at 8½% is approximately $90 million.

(8) Litigation:

The firm has been named a defendant in a number of lawsuits and certain claims are pending. Based upon the opinions of legal counsel and other relevant data, estimated liabilities for uninsured risks with respect to such lawsuits and claims were accrued as of August 31, 1975 and 1974, and are included in other accrued liabilities.

In order to provide equity among partners for lawsuits which may be filed in the future with respect to professional services rendered in the past, the partners have allocated a portion of pro forma capital to cover uninsured risks.

(Staff Note: Booklet entitled "Assuring the Quality of our Professional Practice" retained in committee files.)

ARTHUR ANDERSEN & CO.

G. E. STANTON
VICE CHAIRMAN-ADMINISTRATION

69 WEST WASHINGTON STREET
CHICAGO, ILLINOIS 60602

January 29, 1976

Honorable Lee Metcalf, Chairman
Subcommittee on Reports,
Accounting, and Management
Committee on Government Operations
United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

Enclosed are two copies of our response to your letter and questionnaire of December 19, 1975 (received December 29). Our responses to the questions have been numbered to correspond with the questionnaire submitted to us. We have previously submitted to you, and the members of your Subcommittee, copies of our annual report for each of our past three fiscal years. Also enclosed are two copies of a booklet we recently prepared for distribution to our personnel and our clients entitled "Assuring the Quality of Our Professional Practice."

Please contact Mr. Harvey Kapnick, Chairman and Chief Executive of our firm, or Mr. Charles A. Bowsher, a partner in our Washington, D.C., office who is the Director of our Federal Government Liaison Group, or me, if we can be of further assistance in discussing these matters or providing additional information on our firm.

Very truly yours,

G E Stanton

Enclosures

ARTHUR ANDERSEN & CO.

RESPONSE TO QUESTIONNAIRE OF UNITED STATES SENATE SUBCOMMITTEE ON REPORTS, ACCOUNTING, AND MANAGEMENT

1. Our firm consists of two operating entities in the United States: Arthur Andersen & Co. (an Illinois partnership), which is our principal operating entity; and Arthur Andersen & Co. (a Louisiana partnership), which covers the operations of our New Orleans office. All the data provided herein have been combined for both partnership entities. In addition, we have an inactive United States entity, Arthur Andersen & Co. (a Florida partnership).

   We have forty-eight (48) offices in the United States excluding the Commonwealth of Puerto Rico.

2. As of December 31, 1975, our firm had offices in thirty (30) states, territories and possessions of the United States excluding the Commonwealth of Puerto Rico.

3. As of December 31, 1975, the Arthur Andersen Worldwide Organization had offices in fifty-eight (58) cities located in thirty-five (35) countries (including the Commonwealth of Puerto Rico) outside the United States.

4. As of December 31, 1975, we had six hundred and thirty-eight (638) U.S. partners who are certified public accountants and were located in the United States excluding the Commonwealth of Puerto Rico. In addition, we had sixty (60) U.S. partners who are certified public accountants and were located outside the United States on temporary expatriate assignments including five (5) located in the Commonwealth of Puerto Rico.

5. As of December 31, 1975, we had fifty-six (56) U.S. participating principals located in the United States excluding the Commonwealth of Puerto Rico. In addition we had nine (9) U.S. participating principals located outside the United States on temporary expatriate assignments including one (1) located in the Commonwealth of Puerto Rico. (Participating principals occupy positions substantially equivalent to partners, but do not engage in our accounting and audit practice or our tax practice. They function in our administrative services practice or in certain internal administrative positions in our firm. They are not certified public accountants, and, therefore, may not, under various state statutes, be members of an accounting firm.)

6. As of December 31, 1975, the total number of our United States employees (excluding the Commonwealth of Puerto Rico) was 8,554 (excluding partners and participating principals).

ARTHUR ANDERSEN & CO.

RESPONSE TO QUESTIONNAIRE OF UNITED STATES SENATE SUBCOMMITTEE ON REPORTS, ACCOUNTING, AND MANAGEMENT

7. For our fiscal year ended August 31, 1975, the percentages of our United States revenues (i.e., professional fees) for services performed by our firm were:

A. Accounting and Audit.	66%
B. Tax	18%
C. Administrative Services (i.e., Management Advisory Services).	16%
	100%

D. No actuarial services are provided by our firm.
E. The accounting and audit, tax, and administrative services revenues relating to United States Federal, state or local governments are included in the percentages stated in A, B and C above. Our revenues from such governmental services approximated 3% of our total United States revenues in our fiscal year ended August 31, 1975.
F. We had no "other" revenues of any significance.

Providing the above data on a calendar year basis would require considerable additional analysis and processing of our records. We do not believe that such restatement would change the percentages set forth above.

8. Our firm does not render management or advisory services in any of the following categories:

A. Executive recruitment
B. Marketing analysis - (We do not perform marketing studies designed to measure potential or actual customer acceptance of products.)
C. Plant layout
D. Product analysis
E. Actuarial services
F. Federal Advisory Committees - (Individual members of our firm have served on several United States Federal advisory committees. Payments received for such individual activities and remitted to the firm have been insignificant in amount.)

9. Attached as Exhibit 1 is a listing (as of December 31, 1975) of the names and headquarters' location of the 274 audit clients of our firm with equity securities listed on the New York Stock Exchange. (Full addresses for these companies and those listed on the American Stock Exchange, Exhibit 2, are not available from our computer files, but could be obtained from other sources and furnished, if necessary.)

ARTHUR ANDERSEN & CO.

RESPONSE TO QUESTIONNAIRE OF UNITED STATES SENATE SUBCOMMITTEE ON REPORTS, ACCOUNTING, AND MANAGEMENT

10. Attached as Exhibit 2 is a listing (as of December 31, 1975) of the names and headquarters' location of the 176 audit clients of our firm with equity securities listed on the American Stock Exchange.

11. Our firm is the independent auditor for approximately six thousand (6,000) other clients in the United States. Our central client records do not identify the type of legal entity (i.e., corporation, partnership, proprietorship, individual, etc.) or whether the client is publicly or privately held. We, therefore, cannot answer this question without making a detailed analysis of the client records in each of our offices in the United States.

12. As of December 31, 1975, according to our records, 2,352 of our partners and employees were members of the American Institute of Certified Public Accountants. Participating principals in our firm are not certified public accountants and, therefore, cannot be members of the American Institute of Certified Public Accountants.

13. Our firm has made financial contributions, directly or indirectly, to the Financial Accounting Standards Board in the amount of $200,000 annually in 1973, 1974 and 1975. Other support in the form of partner, manager and staff time, travel expenses, etc., has been provided by having personnel of our firm work on various FASB projects, advisory groups, task forces, etc.

14. Attached as Exhibit 3 is a listing of the departments, agencies or subdivisions of United States Federal, state, municipal or other governmental authorities for which our firm performed services during our fiscal year ended August 31, 1975. This listing is not all-inclusive in that our services to some governmental units (e.g., elementary and secondary schools, colleges and universities, hospitals and other medical facilities, electric, water and gas companies, etc.) may be classified in our records in an industry category other than government services. A detailed analysis of individual clients in various industries would be required in each of our offices to be certain that all governmental units for which we performed services were included.

15. Attached as Exhibit 4 is a listing of the United States Federal government departments, agencies, subdivisions or authorities for which we performed professional services during our fiscal years ended March 31, 1971, 1972, 1973 and 1974, and the five months ended August 31, 1974 (our fiscal year was changed from March 31 to August 31 in 1974). While we believe that we have included all Federal government services in Exhibit 4, it may not be all-inclusive in that some of our services for Federal governmental units may be classified in our records in an industry category other than Federal government services.

ARTHUR ANDERSEN & CO.

RESPONSE TO QUESTIONNAIRE OF UNITED STATES SENATE SUBCOMMITTEE ON REPORTS, ACCOUNTING, AND MANAGEMENT

16. Our firm's annual revenues (i.e., professional fees) for services performed for United States Federal departments, agencies, subdivisions or authorities during each of our last five fiscal years were as follows:

Fiscal Year Ended	Annual Revenues (Professional Fees)
March 31, 1971	$ 528,000
March 31, 1972	2,454,000
March 31, 1973	1,772,000
March 31, 1974	3,801,000
Five months ended August 31, 1974	1,099,000
August 31, 1975	1,197,000

Restatement of these amounts to a calendar year basis would require considerable additional analysis and processing of our records. As mentioned in item 15, these amounts may not be all-inclusive.

17. Our firm has a Federal Government Liaison Group in our Washington, D.C. office for communication and liaison between various Federal government departments and agencies and our offices. Mr. Charles A. Bowsher is the partner in charge of this group and is located at 1666 K Street, N.W., Washington, D.C., 20006 (telephone 785-9510).

January 29, 1976

EXHIBIT 1
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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE NEW YORK STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
A-T-O INC.	WILLOUGHBY, OHIO
ABBOTT LABORATORIES	NORTH CHICAGO, ILL.
AIR PRODUCTS & CHEMICALS, INC.	ALLENTOWN, PA.
ALABAMA POWER CO.	BIRMINGHAM, ALA.
ALCON LABORATORIES, INC.	FORT WORTH, TEXAS
ALLIED PRODUCTS CORPORATION	CHICAGO, ILL.
AMERICAN BAKERIES COMPANY	CHICAGO, ILL.
AMERICAN CHAIN & CABLE CO., INC.	BRIDGEPORT, CONN.
AMERICAN HOME PRODUCTS CORP.	NEW YORK, N.Y.
AMERICAN MEDICAL INTERNATIONAL, INC.	BEVERLY HILLS, CALIF.
AMERICAN NATURAL GAS CO.	NEW YORK, N.Y.
AMERICAN SHIP BUILDING CO. (THE)	LORAIN, OHIO
AMERICAN STERILIZER COMPANY	ERIE, PA.
AMERON, INC.	MONTEREY PARK, CALIF.
AMP INCORPORATED	HARRISBURG, PA.
AMSTAR CORP.	NEW YORK, N.Y.
ANGELICA CORP.	ST. LOUIS, MO.
APACHE CORP.	MINNEAPOLIS, MINN.
APCO OIL CORPORATION	HOUSTON, TEXAS
APPLIED MAGNETICS CORPORATION	GOLETA, CALIF.
ARA SERVICES, INC.	PHILADELPHIA, PA.
ARCTIC ENTERPRISES, INC.	THIEF RIVER FALLS, MINN.
ASA LTD.	JOHANNESBURG, S.AFRICA
AVIS, INC.	GARDEN CITY, N.Y.
BACHE GROUP INC.	NEW YORK, N.Y.
BARD (C.R.) INC.	MURRAY HILL, N.J.
BATH INDUSTRIES, INC.	MILWAUKEE, WIS.
BEKER INDUSTRIES CORP.	GREENWICH, CONN.
BELCO PETROLEUM CORPORATION	NEW YORK, N.Y.
BELL & HOWELL COMPANY	CHICAGO, ILL.
BLISS & LAUGHLIN INDUSTRIES INCORPORATED	OAK BROOK, ILL.
BOISE CASCADE CORPORATION	BOISE, IDAHO
BRAUN (C. F.) & CO.	ALHAMBRA, CALIF.
BRIGGS & STRATTON CORPORATION	WAUWATOSA, WIS.
BROOKLYN UNION GAS CO. (THE)	BROOKLYN, N.Y.
BROWNING-FERRIS INDUSTRIES, INC.	HOUSTON, TEXAS
BRUNSWICK CORPORATION	SKOKIE, ILL.
BUDGET CAPITAL CORPORATION	LOS ANGELES, CALIF.
BUDGET INDUSTRIES, INC.	LOS ANGELES, CALIF.
CALIFORNIA-PACIFIC UTILITIES COMPANY	SAN FRANCISCO, CALIF.
CANAL-RANDOLPH CORPORATION	NEW YORK, N.Y.
CAROLINA FREIGHT CARRIERS CORPORATION	CHERRYVILLE, N.C.
CARRIER CORPORATION	SYRACUSE, N.Y.

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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE NEW YORK STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
CECO CORP.	CHICAGO, ILL.
CENTEX CORPORATION	DALLAS, TEXAS
CENTRAL & SOUTH WEST CORPORATION	WILMINGTON, DEL.
CENTRAL ILLINOIS LIGHT CO.	PEORIA, ILL.
CENTRAL ILLINOIS PUBLIC SERVICE CO.	SPRINGFIELD, ILL.
CENTRAL TELEPHONE & UTILITIES CORP.	LINCOLN, NEBRASKA
CHAMPION INTERNATIONAL CORPORATION	NEW YORK, N.Y.
CHRIS-CRAFT INDUSTRIES, INC.	NEW YORK, N.Y.
CINCINNATI GAS & ELECTRIC CO. (THE)	CINCINNATI, OHIO
CMI INVESTMENT CORP.	MADISON, WIS.
COLGATE-PALMOLIVE COMPANY	NEW YORK, N.Y.
COLLINS FOOD INTERNATIONAL,INC.	LOS ANGELES, CALIF.
COLT INDUSTRIES INC.	NEW YORK, N.Y.
COLUMBIA GAS SYSTEM, INC.	WILMINGTON, DEL.
COLUMBUS & SOUTHERN OHIO ELECTRIC CO.	COLUMBUS, OHIO
COMBUSTION ENGINEERING, INC.	STAMFORD, CONN.
COMMONWEALTH EDISON CO.	CHICAGO, ILL.
COMPUGRAPHIC CORP.	WILMINGTON, MASS.
CONSOLIDATED FOODS CORP.	CHICAGO, ILL.
CONSOLIDATED FREIGHTWAYS, INC.	SAN FRANCISCO, CALIF.
CONSUMERS POWER COMPANY	JACKSON, MICH.
CONTINENTAL ILLINOIS REALTY	LOS ANGELES, CALIF.
CONTINENTAL TELEPHONE CORPORATION	MERRIFIELD, VA.
COOK UNITED INC.	MAPLE HEIGHTS, OHIO
CORDURA CORP.	CHICAGO, ILL.
COUSINS MORTGAGE & EQUITY INVESTMENTS	ATLANTA, GA.
CROCKER NATIONAL CORPORATION	SAN FRANCISCO, CALIF.
CULLIGAN INTERNATIONAL COMPANY	NORTHBROOK, ILL.
CUMMINS ENGINE CO., INC.	COLUMBUS, IND.
CUNNINGHAM DRUG STORES, INC.	DETROIT, MICH.
CUTLER-HAMMER, INC.	MILWAUKEE, WIS.
DAYTON POWER & LIGHT CO. (THE)	DAYTON, OHIO
DELTA AIR LINES, INC.	ATLANTA, GA.
DICK (A.B.) CO.	CHICAGO, ILL.
DISSTON INC.	PITTSBURGH, PA.
DONNELLEY (R.R.) & SONS COMPANY	CHICAGO, ILL.
DORSEY CORPORATION (THE)	CHATTANOOGA, TENN.
DRESSER INDUSTRIES, INC.	DALLAS, TEXAS
DYMO INDUSTRIES, INC.	SAN FRANCISCO, CALIF.
EASTERN GAS & FUEL ASSOCIATES	BOSTON, MASS.
EG&G INC.	BEDFORD, MASS.
ELECTRONIC ASSOCIATES, INC.	WEST LONG BRANCH, N.J.
ELIXIR INDUSTRIES	GARDENA, CALIF.

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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE NEW YORK STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
ENGELHARD MINERALS & CHEMICALS CORP.	NEW YORK, N.Y.
ENTEX, INC.	HOUSTON, TEXAS
ESTERLINE CORP.	NEW YORK, N.Y.
EXCELSIOR INCOME SHARES	NEW YORK, N.Y.
FEDERAL COMPANY	MEMPHIS, TENN.
FEDERAL SIGNAL CORPORATION	CHICAGO, ILL.
FIRST CHICAGO CORP.	CHICAGO, ILL.
FIRST INTERNATIONAL BANCSHARES, INC.	DALLAS, TEXAS
FIRST UNION REAL ESTATE EQUITY & MORT. INV.	CLEVELAND, OHIO
FIRST WISCONSIN MORTGAGE TRUST	MILWAUKEE, WIS.
FLEETWOOD ENTERPRISES	RIVERSIDE, CALIF.
FLEXI-VAN CORPORATION	NEW YORK, N.Y.
FLORIDA GAS CO.	WINTER PARK, FLA.
FLORIDA POWER CORPORATION	ST. PETERSBURG, FLA.
FOOTE, CONE & BELDING COMMUNICATIONS, INC.	CHICAGO, ILL.
FORT HOWARD PAPER COMPANY	GREEN BAY, WIS.
GARDNER-DENVER COMPANY	DALLAS, TEXAS
GENERAL DYNAMICS CORP.	ST. LOUIS, MO.
GENERAL PORTLAND, INC.	DALLAS, TEXAS
GENERAL TELEPHONE & ELECTRONICS CORP.	STAMFORD, CONN.
GENERAL TELEPHONE COMPANY OF FLORIDA	TAMPA, FLA.
GEORGIA POWER COMPANY	ATLANTA, GA.
GEORGIA-PACIFIC CORP.	PORTLAND, OREGON
GETTY OIL COMPANY	LOS ANGELES, CALIF.
GREAT NORTHERN NEKOOSA CORP.	STAMFORD, CONN.
GROLIER INCORPORATED	NEW YORK, N. Y.
GULF RESOURCES & CHEMICAL CORP.	HOUSTON, TEXAS
HALLIBURTON COMPANY	DALLAS, TEXAS
HARCOURT, BRACE JOVANOVICH, INC.	NEW YORK, N.Y.
HAZELTINE CORPORATION	GREENLAWN, N.Y.
HEILEMAN (G.) BREWING CO.	LA CROSSE, WIS.
HELLER (WALTER E.) INTERNATIONAL CORP.	CHICAGO, ILL.
HELMERICH & PAYNE, INC.	TULSA, OKLA.
HERSHEY FOODS CORPORATION	HERSHEY, PA.
HOFFMAN ELECTRONICS CORPORATION	EL MONTE, CALIF.
HOLIDAY INNS, INC.	MEMPHIS, TENN.
HUBBARD REAL ESTATE INVESTMENTS	BOSTON, MASS.
HUTTON (E.F.) GROUP, INC. (THE)	NEW YORK, N.Y.
ILLINOIS TOOL WORKS, INC.	CHICAGO, ILL.
INDIANA GAS CO.	INDIANAPOLIS, IND.
INEXCO OIL CO.	HOUSTON, TEXAS
INSTITUTIONAL INVESTORS TRUST	BOSTON, MASS.

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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
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COMPANY NAME	HEADQUARTERS
INTERNATIONAL PAPER COMPANY	NEW YORK, N.Y.
INTERNATIONAL TELEPHONE & TELEGRAPH CORP.	NEW YORK, N.Y.
IOWA ELECTRIC LIGHT & POWER COMPANY	CEDAR RAPIDS, IOWA
IOWA POWER & LIGHT COMPANY	DES MOINES, IOWA
IOWA PUBLIC SERVICE COMPANY	SIOUX CITY, IOWA
IOWA-ILLINOIS GAS & ELECTRIC CO.	DAVENPORT, IOWA
ITE IMPERIAL CORPORATION	SPRING HOUSE, PA.
ITEK CORPORATION	LEXINGTON, MASS.
ITT CONSUMER SERVICES CORPORATION	NEW YORK, N.Y.
JAMES (FRED S.) & COMPANY, INC.	CHICAGO, ILL.
KANSAS CITY POWER & LIGHT CO.	KANSAS CITY, MO.
KANSAS POWER & LIGHT CO.	TOPEKA, KANSAS
KANSAS-NEBRASKA NATURAL GAS COMPANY, INC.	HASTINGS, NEBRASKA
KEENE CORP.	NEW YORK, N.Y.
KENNAMETAL, INC.	LATROBE, PA.
KENTUCKY UTILITIES CO.	LEXINGTON, KY.
KERR MCGEE CORP.	OKLAHOMA CITY, OKLA.
KIDDE (WALTER) & COMPANY INC.	CLIFTON, N.J.
KIRSCH CO.	STURGIS, MICH.
KOEHRING CO.	MILWAUKEE, WIS.
KRAFTCO CORP.	GLENVIEW, ILL.
LEVI STRAUSS & CO.	SAN FRANCISCO, CALIF.
LFE CORP.	WALTHAM, MASS.
LOUISIANA-PACIFIC CORP.	PORTLAND, OREGON
LOUISVILLE GAS & ELECTRIC CO.	LOUISVILLE, KY.
LUKENS STEEL COMPANY	COATESVILLE, PA.
MACKE COMPANY (THE)	CHEVERLY, MD.
MARCOR INC.	CHICAGO, ILL.
MAREMONT CORPORATION	CHICAGO, ILL.
MARSH & MCLENNAN COMPANIES, INC.	CHICAGO, ILL.
MARLEY COMPANY (THE)	MISSION, KANSAS
MARQUETTE CEMENT MFG. CO.	NASHVILLE, TENN.
MARRIOTT CORP.	WASHINGTON, D.C.
MARSHALL FIELD & CO.	CHICAGO, ILL.
MASONITE CORPORATION	CHICAGO, ILL.
MAY DEPARTMENT STORES CO.	ST. LOUIS, MO.
MCGRAW EDISON CO.	ELGIN, ILL.
MEI CORPORATION	MINNEAPOLIS, MINN.
MERCANTILE STORES COMPANY, INC.	WILMINGTON, DEL.
MERCK & CO., INC.	RAHWAY, N.J.

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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE NEW YORK STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
MESA PETROLEUM CO.	AMARILLO, TEXAS
METRO-GOLDWYN-MAYER, INC.	CULVER CITY, CALIF.
MICHIGAN GAS UTILITIES COMPANY	MONROE, MICH.
MIRRO ALUMINUM CO.	MANITOWOC, WIS.
MISSOURI PUBLIC SERVICE CO.	KANSAS CITY, MO.
MOHAWK DATA SCIENCES CORP.	UTICA, N.Y.
MOORE MCCORMACK RESOURCES INC.	STAMFORD, CONN.
MUTUAL OF OMAHA INTEREST SHARES	OMAHA, NEBRASKA
NATIONAL MEDICAL CARE INC.	BROOKLINE, MASS.
NATIONAL SERVICE INDUSTRIES, INC.	ATLANTA, GA.
NATIONAL TEA CO.	ROSEMONT, ILL.
NATOMAS COMPANY	SAN FRANCISCO, CALIF.
NEVADA POWER COMPANY	LAS VAGAS, NEVADA
NEW ENGLAND GAS & ELECTRIC ASSN.	CAMBRIDGE, MASS.
NEWMONT MINING CORP.	NEW YORK, N.Y.
NORTHERN ILLINOIS GAS CO.	AURORA, ILL.
NORTHERN INDIANA PUBLIC SERVICE CO.	HAMMOND, IND.
NORTHERN NATURAL GAS CO.	OMAHA, NEBRASKA
NORTHWEST INDUSTRIES, INC.	CHICAGO, ILL.
NORTHWEST ENERGY COMPANY	SALT LAKE CITY, UTAH
NORTHWESTERN STEEL & WIRE CO.	STERLING, ILL.
OAK INDUSTRIES, INC.	CRYSTAL LAKE, ILL.
OCCIDENTAL PETROLEUM CORP.	LOS ANGELES, CALIF.
OHIO EDISON COMPANY	AKRON, OHIO
OKLAHOMA GAS & ELECTRIC CO.	OKLAHOMA CITY, OKLA.
OUTBOARD MARINE CORP.	WAUKEGAN, ILL.
OWENS-CORNING FIBERGLAS CORP.	TOLEDO, OHIO
PARGAS INC.	WALDORF, MD.
PARKER PEN COMPANY	JANESVILLE, WIS.
PASCO, INC.	NEW YORK, N.Y.
PENNWALT CORP.	PHILADELPHIA, PA.
PENNZOIL COMPANY	HOUSTON, TEXAS
PEOPLES DRUG STORES, INC.	WASHINGTON, D.C.
PEOPLES GAS COMPANY	CHICAGO, ILL.
PORTLAND GENERAL ELECTRIC CO.	PORTLAND, OREGON
PUBLIC SERVICE CO. OF INDIANA, INC.	PLAINFIELD, IND.
QUAKER OATS COMPANY	CHICAGO, ILL.
REECE CORPORATION (THE)	WALTHAM, MASS.
RELIABLE STORES CORPORATION	BALTIMORE, MD.
REPUBLIC CORPORATION	LOS ANGELES, CALIF.
REPUBLIC MORTGAGE INVESTORS	CORAL GABLES, FLA.
RETAIL CREDIT COMPANY	ATLANTA, GA.
REXNORD, INC.	MILWAUKEE, WIS.
RICHARDSON CO.	DES PLAINES, ILL.
RIEGEL TEXTILE CORPORATION	NEW YORK, N.Y.

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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE NEW YORK STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
SARGENT-WELCH SCIENTIFIC CO.	SKOKIE, ILL.
SCHLITZ (JOS.) BREWING COMPANY	MILWAUKEE, WIS.
SCOTT, FORESMAN & COMPANY	GLENVIEW, ILL.
SCOTTY'S INC.	WINTER HAVEN, FLA.
SEALED POWER CORP.	MUSKEGON, MICH.
SEARLE (G. D.) & CO.	SKOKIE, ILL.
SIGNODE CORP.	GLENVIEW, ILL.
SKELLY OIL COMPANY	TULSA, OKLA.
SMITH INTERNATIONAL, INC.	NEWPORT BEACH, CALIF.
SOUTHERN CALIFORNIA EDISON CO.	ROSEMEAD, CALIF.
SOUTHERN COMPANY (THE)	ATLANTA, GA.
SOUTHERN INDIANA GAS & ELECTRIC CO.	EVANSVILLE, IND.
ST. JOSEPH LIGHT & POWER CO.	ST. JOSEPH, MO.
STANDARD BRANDS, INC.	NEW YORK, N.Y.
STANRAY CORPORATION	CHICAGO, ILL.
STEWART-WARNER CORPORATION	CHICAGO, ILL.
STORAGE TECHNOLOGY CORP.	LOUISVILLE, COLO.
STUDEBAKER-WORTHINGTON, INC.	NEW YORK, N.Y.
SUAVE SHOE CORP.	MIAMI LAKES, FLA.
SUN CHEMICAL CORPORATION	NEW YORK, N.Y.
SUPERIOR OIL COMPANY	HOUSTON, TEXAS
TAPPAN COMPANY (THE)	MANSFIELD, OHIO
TELEDYNE INC.	LOS ANGELES, CALIF.
TENNECO, INC.	HOUSTON, TEXAS
TEXACO, INC.	NEW YORK, N.Y.
TEXAS GAS TRANSMISSION CORP.	OWENSBORO, KY.
THRIFTY DRUG STORES CO., INC.	LOS ANGELES, CALIF.
TIGER INTERNATIONAL, INC.	LOS ANGELES, CALIF.
TOLEDO EDISON COMPANY	TOLEDO, OHIO
TRANS UNION CORP.	LINCOLNSHIRE, ILL.
TRANSCO COMPANIES INC.	HOUSTON, TEXAS
TRIANGLE PACIFIC CORP.	GREAT NECK, N.Y.
U.S. HOME CORPORATION	CLEARWATER, FLA.
UAL INC.	CHICAGO, ILL.
UARCO INCORPORATED	BARRINGTON, ILL.
UNARCO INDUSTRIES, INC.	CHICAGO, ILL.
UNION COMMERCE CORP.	CLEVELAND, OHIO
UNITED GAS PIPE LINE COMPANY	HOUSTON, TEXAS
UNITED STATES GYPSUM CO.	CHICAGO, ILL.
UNITED STATES SHOE CORP.	CINCINNATI, OHIO
UNIVAR CORPORATION	SEATTLE, WASH.
UNIVERSAL OIL PRODUCTS CO.	DES PLAINES, ILL.
UTAH INTERNATIONAL, INC.	SAN FRANCISCO, CALIF.
VENDO COMPANY	KANSAS CITY, MO.
VSI CORP.	PASADENA, CALIF.

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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE NEW YORK STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
WALGREEN COMPANY	CHICAGO, ILL.
WALLACE BUSINESS FORMS, INC.	HILLSIDE, ILL.
WALLACE-MURRAY CORP.	NEW YORK, N.Y.
WARNER COMPANY	PHILADELPHIA, PA.
WASHINGTON GAS LIGHT CO.	WASHINGTON, D.C.
WASTE MANAGEMENT, INC.	OAK BROOK, ILL.
WELLS FARGO MORTGAGE INVESTORS	LOS ANGELES, CALIF.
WEYENBERG SHOE MANUFACTURING COMPANY	MILWAUKEE, WIS.
WEYERHAEUSER CO.	TACOMA, WASH.
WHEELABRATOR-FRYE INC.	NEW YORK, N.Y.
WILSHIRE OIL COMPANY OF TEXAS	NEW YORK, N.Y.
WISCONSIN GAS CO.	MILWAUKEE, WIS.
WISCONSIN PUBLIC SERVICE CORP.	GREEN BAY, WIS.
XTRA, INC.	BOSTON, MASS.
ZAPATA, INC.	HOUSTON, TEXAS
ZENITH RADIO CORPORATION	CHICAGO, ILL.

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EXHIBIT 2
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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE AMERICAN STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
A & E PLASTIC PAK CO., INC.	INDUSTRY, CALIF.
AAR CORP.	ELK GROVE VILLAGE, ILL.
ACME PRECISION PRODUCTS INC.	DETROIT, MICH.
AEGIS CORPORATION	CORAL GABLES, FLA.
AERO-FLOW DYNAMICS, INC.	LINDEN, N.J.
AFFILIATED PUBLICATIONS, INC.	BOSTON, MASS.
AMERICAN FLETCHER MORTGAGE INVESTORS	BOSTON, MASS.
AMERICAN GARDEN PRODUCTS, INC.	BOSTON, MASS.
AMERICAN SCIENCE & ENGINEERING INC.	CAMBRIDGE, MASS.
AMERICAN TRAINING SERVICES INC.	CHERRY HILL, N.J.
ARGUS, INC.	ANN ARBOR, MICH.
ARMIN CORP.	JERSEY CITY, N.J.
ATALANTA CORP.	NEW YORK, N.Y.
AUSTRAL OIL CO. INC.	HOUSTON, TEXAS
BANNER INDUSTRIES, INC.	CLEVELAND, OHIO
BARNES ENGINEERING CO.	STAMFORD, CONN.
BAYROCK UTILITY SECURITIES	NEW YORK, N.Y.
BUILDEX INC.	HUNTINGTON, N.Y.
BURNS INTERNATIONAL SECURITY SERVICES, INC.	BRIARCLIFF, N.Y.
C & K PETROLEUM, INC.	HOUSTON, TEXAS
CAMCO INC.	HOUSTON, TEXAS
CANADIAN OCCIDENTAL PETROLEUM	CALGARY, ALBERTA
CAROLINA PIPELINE CO.	COLUMBIA, S.C.
*CARRIER CORPORATION	SYRACUSE, N.Y.
CASTLE (A.M.) & CO.	FRANKLIN PARK, ILL.
CASTLEWOOD INTERNATIONAL CORP.	MIAMI, FLA.
CAVITRON CORP.	LONG ISLAND CITY, N.Y.
CENTRAL POWER & LIGHT CO. (TEXAS)	CORPUS CHRISTI, TEXAS
CETEC CORP.	SOUTH EL MONTE, CALIF.
*CMI INVESTMENT CORP.	MADISON, WIS.
COLE NATIONAL CORP.	CLEVELAND, OHIO
COMMODORE BUSINESS MACHINES (CANADA) LTD.	PALO ALTO, CALIF.
COMMODORE CORPORATION (THE)	OMAHA, NEBRASKA
CONCHEMCO INC. (DEL)	SHAWNEE MISSION, KANSAS
*CONTINENTAL TELEPHONE CORPORATION	MERRIFIELD, VA.
CORE LABORATORIES INC.	DALLAS, TEXAS
*COUSINS MORTGAGE & EQUITY INVESTMENTS	ATLANTA, GA.

* The common stock of this company is listed on the New York Stock Exchange (Exhibit 1), and either preferred stock or warrants of the company are listed on the American Stock Exchange.

EXHIBIT 2
Page 2 of 5

AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE AMERICAN STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
CRAMER ELECTRONICS INC.	NEWTON, MASS.
DAMSON OIL CORPORATION	NEW YORK, N.Y.
DE ROSE INDUSTRIES INC.	INDIANAPOLIS, IND.
DEPOSITORS CORP.	AUGUSTA, MAINE
DYNALECTRON CORP.	WASHINGTON, D.C.
ECODYNE CORP.	LINCOLNSHIRE, ILL.
ELCOR CHEMICAL CORP.	MIDLAND, TEXAS
ELECTRONIC ASSISTANCE CORP.	PARAMUS, N.J.
ESSEX CHEMICAL CORP.	CLIFTON, N.J.
EUTHENICS SYSTEMS CORPORATION	BEAVER, PA.
FABRI-CENTERS OF AMERICA INC.	BEACHWOOD, OHIO
FALCON SEABOARD INC.	HOUSTON, TEXAS
FELMONT OIL CORP.	NEW YORK, N.Y.
FILMWAYS, INC.	LOS ANGELES, CALIF.
FINANCIAL GENERAL BANKSHARES, INC.	WASHINGTON, D.C.
FIRST HARTFORD CORP.	MANCHESTER, CONN.
FIRST VIRGINIA MORTGAGE & R.E.I.T.	FALLS CHURCH, VA.
FOOTE MINERAL COMPANY	EXTON, PA.
FRANTZ MANUFACTURING CO.	STERLING, ILL.
FRIGITEMP CORP.	NEW YORK, N.Y.
GABRIEL INDUSTRIES, INC.	NEW YORK, N.Y.
GENERAL RECREATION INC.	ALBUQUERQUE, N.M.
GENERAL RESEARCH CORP.	SANTA BARBARA, CALIF.
GEON INDUSTRIES INC.	WOODBURY, N.Y.
GLADDING CORP.	BOSTON, MASS.
GLASROCK PRODUCTS, INC.	ATLANTA, GA.
GLOBE INDUSTRIES, INC.	CHICAGO, ILL.
GLOUCESTER ENGINEERING CO., INC.	GLOUCESTER, MASS.
GOLDBLATT BROS., INC.	CHICAGO, ILL.
GOLDEN WEST MOBILE HOMES INC.	SANTA ANA, CALIF.
GREAT BASINS PETROLEUM CO.	LOS ANGELES, CALIF.
GTI CORP.	PITTSBURGH, PA.
GUILFORD MILLS, INC.	GREENSBORO, N.C.
GULF REPUBLIC FINANCIAL CORP.	HOUSTON, TEXAS
HARVEY'S STORES, INC.	NEW YORK, N.Y.
HI-SHEAR CORP.	TORRANCE, CALIF.
HOTEL INVESTORS (THE)	KENSINGTON, MD.
INCOTERM CORPORATION	NATTICK, MASS.

EXHIBIT 2
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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE AMERICAN STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
INLAND CREDIT CORP.	NEW YORK, N.Y.
INSTRUMENT SYSTEMS CORP.	HUNTINGTON, N.Y.
INTERMEDCO, INC.	HOUSTON, TEXAS
INTERNATIONAL ALUMINUM CORPORATION	MONTEREY PARK, CALIF.
INTERNATIONAL GENERAL INDUSTRIES, INC.	WASHINGTON, D.C.
INTERPHOTO CORP.	LONG ISLAND CITY, N.Y.
INTERPOOL LTD.	NEW YORK, N.Y.
ITI CORP.	CINCINNATI, OHIO
JACOBS ENGINEERING GROUP, INC.	PASADENA, CALIF.
K-TEL INTERNATIONAL INC.	MINNEAPOLIS, MINN.
KEYSTONE INDUSTRIES INC.	CHICAGO, ILL.
KING RADIO CORP.	OLATHE, KANSAS
KIRBY INDUSTRIES, INC.	HOUSTON, TEXAS
KLEINERT'S INC.	NEW YORK, N.Y.
KLIKLOK CORP.	GREENWICH, CONN.
LCA CORP.	BALA CLNWYD, PA.
LOUISIANA GENERAL SERVICES, INC.	HARVEY, LA.
MARK CONTROLS CORP.	EVANSTON, ILL.
MARSHALL INDUSTRIES	EL MONTE, CALIF.
MEDALIST INDUSTRIES INC.	MILWAUKEE, WIS.
MICHIGAN GENERAL CORP.	DALLAS, TEXAS
MITCHELL ENERGY & DEVELOPMENT	HOUSTON, TEXAS
MODERN MAID FOOD PRODUCTS INC.	GARDEN CITY, N.Y.
MULTI-AMP CORP.	DALLAS, TEXAS
NELSON (L.B.) CO.	MENLO PARK, CALIF.
NOEL INDUSTRIES, INC.	NEW YORK, N.Y.
NORTEK INC.	CRANSTON, R.I.
NORTH AMERICAN ROYALTIES INC.	CHATTANOOGA, TENN.
* NORTHERN INDIANA PUBLIC SERVICE CO.	HAMMOND, IND.
OAKWOOD HOMES CORP.	GREENSBORO, N.C.
ORMAND INDUSTRIES INC.	LOS ANGELES, CALIF.
OUTDOOR SPORTS INDUSTRIES, INC.	DENVER, COLO.
PACIFIC HOLDING CORP.	LOS ANGELES, CALIF.
PARKWAY DISTRIBUTORS, INC.	HOLBROOK, MASS.
PAXALL, INC.	SKOKIE, ILL.
PENN. REAL ESTATE INVESTMENT TRUST	WYNCOTE, PA.
PERINI CORPORATION	FRAMINGHAM, MASS.
PERTEC CORP.	EL SEGUNDO, CALIF.

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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE AMERICAN STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
PETRO-LEWIS CORPORATION	DENVER, COLO.
PIONEER SYSTEMS, INC.	MANCHESTER, CONN.
PIONEER TEXAS CORP.	DALLAS, TEXAS
PLANT INDUSTRIES, INC. (DEL)	ANAHEIM, CALIF.
POLYCHROME CORP.	YONKERS, N.Y.
PRUDENTIAL BLDG. MAINTENANCE CORP.	NEW YORK, N.Y.
REAL ESTATE INVESTMENT TRUST OF AMER.	BOSTON, MASS.
REALTY REFUND TRUST	CLEVELAND, OHIO
REIT INCOME FUND INC.	BOSTON, MASS.
REPUBLIC MORTGAGE INVESTORS	CORAL GABLES, FLA.
RICHTON INTERNATIONAL CORP.	NEW YORK, N.Y.
RILEY CO. (THE)	PARK RIDGE, ILL.
ROCOR INTERNATIONAL	PALO ALTO, CALIF.
RSC INDUSTRIES	HIALEAH, FLA.
RYERSON & HAYNES, INC.	JACKSON, MICH.
SALEM CORPORATION	PITTSBURGH, PA.
SCIENTIFIC-ATLANTA, INC.	ATLANTA, GA.
SCRIVNER INC.	OKLAHOMA CITY, OKLA.
SECURITY MORTGAGE INVESTORS	BOSTON, MASS.
SEMTECH CORPORATION	NEWBURY PARK, CALIF.
SERVO CORP. OF AMERICA	HICKSVILLE, N.Y.
SHAW INDUSTRIES, INC.	DALTON, GA.
SHENANDOAH OIL CORP.	FORT WORTH, TEXAS
SHERWOOD MEDICAL INDUSTRIES INC.	ST. LOUIS, MO.
SIFCO INDUSTRIES, INC.	CLEVELAND, OHIO
*SOUTHERN CALIFORNIA EDISON CO.	ROSEMEAD, CALIF.
SPEED-O-PRINT BUSINESS MACHINES CORP.	CHICAGO, ILL.
SPLENTEX INC.	NEW YORK, N.Y.
STANDARD METALS CORP.	DENVER, COLO.
STANDARD PRODUCTS CO. (THE)	CLEVELAND, OHIO
STANDARD-PACIFIC CORP.	COSTA MESA, CALIF.
STATE SAVINGS & LOAN ASSOCIATION	STOCKTON, CALIF.
STELLAR INDUSTRIES, INC.	BUENA PARK, CALIF.
STEPAN CHEMICAL CO.	NORTHFIELD, ILL.
STERLING ELECTRONICS CORPORATION	HOUSTON, TEXAS

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AUDIT CLIENTS OF ARTHUR ANDERSEN & CO.
LISTED ON THE AMERICAN STOCK EXCHANGE
AS OF DECEMBER 31, 1975

COMPANY NAME	HEADQUARTERS
STEVCOKNIT INC.	NEW YORK, N.Y.
SUN ELECTRIC CORP.	CHICAGO, ILL.
SUNAIR ELECTRONICS, INC.	FORT LAUDERDALE, FLA.
SUPER FOOD SERVICES, INC.	DAYTON, OHIO
SUPERIOR INDUSTRIES INTERNATIONAL INC.	VAN NUYS, CALIF.
SW INDUSTRIES INC.	PROVIDENCE, R.I.
TECHNICAL OPERATIONS, INC.	BOSTON, MASS.
* TENNECO, INC.	HOUSTON, TEXAS
TENNESSEE FORGING STEEL CORP.	HARRIMAN, TENN.
* TIGER INTERNATIONAL, INC.	LOS ANGELES, CALIF.
TMC MORTGAGE INVESTORS	BOSTON, MASS.
* TOLEDO EDISON COMPANY	TOLEDO, OHIO
TORIN CORP.	TORRINGTON, CONN.
U.I.P. CORPORATION	ELK GROVE VILLAGE, ILL.
U.S. LEASING REAL ESTATE INVESTORS	SAN FRANCISCO, CALIF.
UNION INVESTMENT CO.	BIRMINGHAM, MICH.
UNIVERSAL RESOURCES CORP.	DALLAS, TEXAS
URS CORP.	SAN MATEO, CALIF.
VESELY COMPANY	LAPEER, MICH.
WACKENHUT CORP. (THE)	CORAL GABLES, FLA.
WAINOCO OIL CO., LTD.	HOUSTON, TEXAS
WEST TEXAS UTILITIES CO.	ABILENE, TEXAS
WESTATES PETROLEUM CO.	LOS ANGELES, CALIF.
WHITAKER CABLE CORP.	NORTH KANSAS CITY, MO.
WILSHIRE OIL CO. OF TEXAS	NEW YORK, N.Y.
WINKELMAN STORES, INC.	DETROIT, MICH.
WISCONSIN POWER & LIGHT CO.	MADISON, WIS.
WYLE LABORATORIES	EL SEGUNDO, CALIF.

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EXHIBIT 3
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LISTING OF DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF UNITED STATES FEDERAL, STATE OR LOCAL GOVERNMENTAL AUTHORITIES FOR WHICH ARTHUR ANDERSEN & CO. PERFORMED SERVICES DURING THE FISCAL YEAR ENDED AUGUST 31, 1975

Federal Government

Department of Commerce
Department of the Interior
Department of Justice -
U.S. Attorney of Bergen County, New Jersey
Department of Transportation
Department of the Treasury
Department of the Navy
Federal Energy Administration
Federal Home Loan Bank Board
Federal Home Loan Mortgage Corporation
Federal Reserve System
General Accounting Office
General Services Administration
National Aeronautics and Space Administration
National Railroad Passenger Corporation
Panama Canal Company
Social Security Administration
U.S. Agency for International Development

tate Government

Alabama	- Commission on Aging - Department of Health
Alaska	- The North Commission
Arizona	- Auditor General
Colorado	- State Supreme Court
Connecticut	- State Election Commission
Georgia	- Department of Human Resources
Illinois	- Building Authority - Department of Finance - Department of Labor - Health Facilities Authority - Illinois Housing Development Authority - Illinois Racing Board - Office of Comptroller - State Department of Health - State Fair Agency - State Treasury Department - Technical Assistance Corporation for Housing

LISTING OF DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF UNITED STATES FEDERAL, STATE OR LOCAL GOVERNMENTAL AUTHORITIES FOR WHICH ARTHUR ANDERSEN & CO. PERFORMED SERVICES DURING THE FISCAL YEAR ENDED AUGUST 31, 1975

State Government (continued)

Louisiana	- Division of Administration
Maine	- Balanced Growth for Maine - Data Processing Services
Maryland	- Mass Transit Administration
Massachusetts	- Department of Welfare - Economic Development and Industrial Corp.
Michigan	- Department of Administration - Department of Management and Budget - Department of Public Health - Housing Development Authority
Mississippi	- Department of Public Welfare
Missouri	- Division of Commerce and Industrial Development - Division of Liquor Control - Office of Administration
Nebraska	- Department of Administrative Services - Department of Public Institutions
New Hampshire	- Central Data Processing Department
New Jersey	- Department of Institutions and Agencies - Division of Investments - Health Care Facilities Financing Authority - State Auditor
New York	- Department of Audit
North Dakota	- Department of Accounts and Purchases - State Highway Department
Ohio	- Bureau of Workman's Compensation - Finance Department - Ohio Building Authority
Oregon	- Mental Health Division
Pennsylvania	- Bureau of Financial Management - Office of Administration

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LISTING OF DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF UNITED STATES
FEDERAL, STATE OR LOCAL GOVERNMENTAL AUTHORITIES
FOR WHICH ARTHUR ANDERSEN & CO. PERFORMED SERVICES
DURING THE FISCAL YEAR ENDED AUGUST 31, 1975

State Government (continued)

South Carolina	- Criminal Justice Planning Agency
	- Department of Health
	- Wildlife and Marine Resources Department
Washington	- Department of Social and Health Services
	- State Hospital Commission
Utah	- Office of State Auditor

Local Government

Alabama	- City of Sheffield
Arizona	- City of Mesa
	- Salt River Irrigation District
California	- Bay Area Rapid Transit District
	- City of Los Angeles
	- County of Los Angeles
	- County of Santa Clara
	- Los Angeles Regional Transportation District
	- San Diego Comprehensive Planning Organization
	- San Diego Transit Corporation
	- San Francisco Department of Public Health
	- Southern California Rapid Transit District
Colorado	- Broadmoor Sanitation District
	- Denver Regional Transportation District
	- Platte River Power Authority
	- Pueblo Project Outlook Metropolitan District
	- Town of Columbine Valley
	- Winter Park West Water and Sanitation District
Connecticut	- Hartford Regional Transportation District
Florida	- City of Bartow
	- Orlando Central Business District
	- Tampa Bay Area Rapid Transit Authority
	- Town of Redington Shores
Georgia	- Central Atlanta Progress, Inc.
	- Metropolitan Atlanta Rapid Transit Authority

EXHIBIT 3
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LISTING OF DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF UNITED STATES
FEDERAL, STATE OR LOCAL GOVERNMENTAL AUTHORITIES
FOR WHICH ARTHUR ANDERSEN & CO. PERFORMED SERVICES
DURING THE FISCAL YEAR ENDED AUGUST 31, 1975

Local Government (continued)

Illinois	- Calumet Skyway Toll Bridge
	- Chicago Board of Education
	- Chicago Regional Transportation District
	- Chicago Transit Authority
	- Chicago Urban Transportation District
	- City of Burbank
	- City of Chicago
	- City of Peoria
	- Deerfield Bannockburn Fire Protection District
	- Lake County Public Water District
	- Mayor's Office of Manpower
	- Village of Riverwoods
	- Village of Streamwood
	- West Suburban Mass Transit District
Indiana	- Indiana Transit Authority
	- Indianapolis Community Services Council
	- Indianapolis Department of Administration
	- Indianapolis Department of Parks
	- Indianapolis Department of Public Safety
	- Knox County Hospital Association
	- Warren Township Assessor
Maryland	- Anne Arundel County
	- Board of Education of Washington County
	- Prince Georges Board of Education
	- Prince Georges Board of Health
Massachusetts	- Boston Regional Transportation District
	- City of Boston
	- Massachusetts Bay Transportation Authority
	- Southeastern Regional Transit Authority
Michigan	- City of Detroit
	- City of Detroit - Finance Department
	- City of Grand Rapids
	- City of Highland Park
	- Detroit Board of Education
	- Detroit Community Development Commission
	- Detroit Controller's Office
	- Detroit Health Service
	- Detroit Police Department
	- Muskegon County
	- Oakland City Drainage District
	- Wayne County Stadium Authority

LISTING OF DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF UNITED STATES FEDERAL, STATE OR LOCAL GOVERNMENTAL AUTHORITIES FOR WHICH ARTHUR ANDERSEN & CO. PERFORMED SERVICES DURING THE FISCAL YEAR ENDED AUGUST 31, 1975

Local Government (continued)

Minnesota
- Association of School Administrators
- Hennepin County
- Hennepin County Park Reserve District
- Seaway Port Authority of Duluth
- Town of White-Bear
- Township of Stillwater

Missouri
- City of Des Peres
- City of Springfield
- Greater Kansas City Foreign Trade Zone
- Jackson County Sports Complex Authority
- Kansas City Area Transit Authority
- Model Cities Comprehensive Neighborhood Health Center
- Regional Justice Information System
- St. Louis Metropolitan Airport Authority

New Jersey
- Borough of Ho-Ho-Koo

New York
- Batavia Housing Authority
- Fund for the City of New York
- Model Cities Administration - Fire Department
- Model Cities Administration - Police Department
- Model Cities Administration - Sanitation Department
- Model Cities Administration - Youth Services Administration
- New York City Addiction Services Agency
- New York City Transit Authority
- New York State Moreland Act Commission
- Rochester Housing Authority
- Town of Perington

Ohio
- City of Cincinnati
- City of Loveland
- Cleveland Central Collection Agency
- Cleveland Regional Income Tax Agency
- Criminal Justice Coordinating Council of Greater Cleveland
- Ohio-Kentucky-Indiana Regional Planning Authority
- Queen City Metropolitan Transit Authority
- Sheriff of Cuyahoga County

Oklahoma
- City of Tulsa
- Oklahoma City Development Trust
- Tulsa Metropolitan Ministry

EXHIBIT 3
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LISTING OF DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF UNITED STATES
FEDERAL, STATE OR LOCAL GOVERNMENTAL AUTHORITIES
FOR WHICH ARTHUR ANDERSEN & CO. PERFORMED SERVICES
DURING THE FISCAL YEAR ENDED AUGUST 31, 1975

Local Government (continued)

Pennsylvania	- City of Philadelphia
South Carolina	- City of Charlotte
Tennessee	- Chattanooga Regional Transit Authority
Texas	- City of Houston - Dallas Water Utility Department - Harris County Child Welfare Unit - Polk County - Town of Westover Hills
Virginia	- City of Rockville - Fairfax-Falls Church Community Mental Health and Mental Retardation Board - North Virginia Planning District Commission
Washington	- King County Courthouse - Public Utility District of Chelan County
Wisconsin	- Racine County
District of Columbia	- Council of Urban Economics - D.C. Model Cities Economic Development Corporation - Interstate Conference of Employment Security Agencies - Model Cities Program - Northwest Settlement House - Office of Housing - Regional Transportation District

EXHIBIT 4
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UNITED STATES FEDERAL DEPARTMENTS, AGENCIES, SUBDIVISIONS OR AUTHORITIES
FOR WHICH ARTHUR ANDERSEN & CO. PERFORMED SERVICES
DURING THE FISCAL YEARS ENDED MARCH 31, 1971, 1972, 1973 AND 1974
AND THE FIVE MONTHS ENDED AUGUST 31, 1974

	Fiscal Year Ended March 31, 1971	1972	1973	1974	Five Months Ended Aug. 31, 1974
Department of Commerce			X	X	
Department of the Interior		X	X	X	X
Department of Transportation		X	X	X	X
Department of the Treasury			X	X	X
Department of the Navy				X	X
Federal Home Loan Bank Board	X	X	X	X	X
Federal Home Loan Mortgage Corporation	X	X	X	X	X
Federal Judicial Center			X	X	
Federal Reserve System				X	X
Federal Savings and Loan Insurance Corporation	X				
General Accounting Office			X	X	X
House of Representatives				X	
National Aeronautics and Space Administration	X	X	X	X	X
National Railroad Passenger Corporation	X	X	X	X	X
Office of Economic Opportunity	X				
Panama Canal Company	X	X	X	X	X
Selective Service Commission	X				
St. Lawrence Seaway Development Corporation		X			
U.S. Courts Administration			X	X	
U.S. Price Commission		X	X	X	

ARTHUR YOUNG & COMPANY

277 PARK AVENUE
NEW YORK, N. Y. 10017

February 20, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee of Reports
Accounting and Management
United States Senate
161 Russell Building
Washington, D. C. 20510

Dear Senator Metcalf:

I am enclosing Arthur Young & Company's response to the Questionnaire accompanying your letter to me dated December 19, 1975.

Our records are not maintained in a manner which facilitates providing the information you have requested. However, we have made special analyses of detailed tabulations and records from sources within and outside the firm to ensure that the information provided is as complete as possible. We believe our answers are responsive to your questionnaire.

Very truly yours,

William S. Kanaga

William S. Kanaga

Enclosures

RESPONSES TO QUESTIONNAIRE

OF

US SENATE SUBCOMMITTEE ON REPORTS

ACCOUNTING AND MANAGEMENT

Arthur Young & Company
February 1976

1. Please state the number of offices which your firm maintains within the United States (If more than one partnership, corporation or other entity exists in the United States, please furnish all names and answer subsequent questions accordingly.)

   Arthur Young & Company (including Arthur Young & Company Puerto Rico) maintains offices in 64 cities in the United States.

2. Please indicate the number of states, territories or possessions of the United States in which your firm maintains an office or affiliated office.

   Offices are located in 35 states or territories including the District of Columbia and Puerto Rico.

3. Please state the number of cities outside the United States in which you firm maintains offices or has an affiliation.

   The firm maintains offices or has affiliated partnerships or representation agreements with firms with offices in approximately 150 cities outside of the United States.

4. Please state the number of partners in your firm located in the United States (include only certified public accountants.)

   The firm had 414 partners who are certified public accountants and were located in the United States at February 1, 1976.

5. Please state the number of principals located in your offices in the United States who are not certified public accountants.

   We believe the rank you refer to as "principal" is most nearly equivalent to our rank of "Director". The firm had 50 Directors in offices in the United States at February 1, 1976.

6. Please state the total number of employees of your firm within the United States, excluding only partners and principals.

   The total average number of employees in the United States (excluding partners and directors) during the month of January 1976 was approximately 4,800.

7. Please indicate the approximate percentage of total revenues for services performed by your firm in the following categories:

   A. Auditing and accounting
   B. Tax service
   C. Management advisory services including executive recruitment, product analysis, marketing analysis, and plant layout.
   D. Actuarial services
   E. Services performed for Federal, State or local governments
   F. Other

   All of our services are classified as Auditing and Accounting, Tax or Management Advisory Services. During the fiscal year ended September 30, 1975, the percentages of services were approximately as follows:

Auditing and Accounting	69%
Tax services	17%
Management advisory services	14%

   We do not perform actuarial services.

   Our records do not separately accumulate data relating to services performed for Federal, State and local governments. For purposes of answering this questionnaire, we have, however, reviewed tabulations of billings to clients and, based on this review, we estimate that services for governments represented approximately 5 to 10% of the total of above services.

8. Please state if your firm renders management or other advisory services in the following categories:

   A. Executive recruitment
   B. Marketing analysis
   C. Plant layout
   D. Product analysis
   E. Actuarial services
   F. Federal advisory committees

   Our firm renders services in executive recruitment. We have performed services in the areas of marketing analysis, product analysis and plant layout; however, our work in these areas represents an insignificant portion of our management advisory services and is normally limited to fact gathering or is incidental to our work in other areas such as cost accounting and management control systems. We do not perform actuarial services, nor do we serve on federal advisory committees.

9. Please state the name and address of corporations listed on the New York Stock Exchange for which your firm is the independent auditor.

   (See attached Schedule A)

10. Please state the name and address of corporations listed on the American Stock Exchange for which your firm is the independent auditor.

   (See attached Schedule B)

11. Please state the number of other publicly-held corporations for which your firm is the independent auditor, and the number of privately held corporations for which your firm is the independent auditor.

   As of October 1975, the number of other publicly-held corporations (Those with securities registered with the Securities Exchange Commission (SEC) and subject to further reporting to the SEC which are not included in Schedules A or B) was approximately 430.

   We maintain a comprehensive list of clients whose annual fees exceed $7,500. As of October 1975, that list included approximately 1,950 privately-held clients for which we perform audit services.

12. Please indicate the total number of partners, principals, and employees of your firm who are members of the American Institute of Certified Public Accountants.

The number of partners, directors and employees in our firm who are members of the American Institute of Certified Public Accounts was approximately 2,140 at January 31, 1976.

13. Please state if your firm has made financial contributions, directly or indirectly, to the Financial Accounting Standards Board. If so, please indicate the amount of contributions made annually to date.

Our firm has made contributions to the Financial Accounting Standards Board, directly or through the Accounting Research Association, in the years ended December 31 as follows:

1975	$350,000
1974	200,000
1973	200,000

14. Please identify the departments, agencies or subdivisions of any federal, state, municipal or other government authority for which your firm performed any services during 1975.

(See attached Schedule C)

15. Please identify the federal departments, agencies, subdivisions or authorities for which you firm has performed services during each year from January 1, 1970 through December 31, 1974.

(See attached Schedule D)

16. Please state your firm's annual gross revenue from services performed for Federal departments, agencies, subdivisions or authorities during each year from January 1, 1970 to December 31, 1975.

Our services performed for Federal departments, agencies, subdivisions or authorities are, with minor exceptions, billed by our office in Washington, D.C. (located in Bethesda prior to 1971) and comprise virtually all of the revenues of that office in the years for which data is requested. Revenues for that office in the years ending December 31 were as follows (in 000's):

1975	$4,650
1974	4,010
1973	2,960
1972	1,320
1971	270
1970	430

17. Please state if your firm maintains a department, division or office for the procurement of Federal, State and local government contracts. If so, please indicate the name of the person(s) in charge of said department, division or office, and address of such office(s).

All of our offices may perform services under Federal, State and local government contracts. In the following offices, services performed are predominantly under government contracts:

Office	Person In Charge
Twin Towers, Capitol Hill 99 Washington Avenue Albany, New York 12210	John R. Nolan
901 Vaughn Building 807 Brazos Street Austin, Texas 78701	Richard L. Brown
100 Chestnut Street, Suite 200 Suite 200 Harrisburg, Penna. 17101	David A. Tierno
555 Capitol Mall Suite 1490 Sacramento, Calif. 95814	Ronald G. Witcosky
1025 Connecticut Avenue, N.W. Washington, D. C. 20036	William C. O'Malley

Schedule A

AUDIT CLIENTS OF ARTHUR YOUNG & COMPANY WHOSE EQUITY SECURITIES WERE LISTED ON THE N.Y. STOCK EXCHANGE AS OF NOVEMBER 30, 1975*

Akzona, Incorporated	Asheville, N.C.
Alabama Gas Corporation	Birmingham, Alabama
Alison Mortgage Investment Trust	Newport Beach, Calif.
Allright Auto Parks, Inc.	Houston, Texas
Amerada Hess Corporation[1]	New York, N.Y.
American Airlines, Inc.	New York, N.Y.
American Distilling Company, The	New York, N.Y.
American Standard Inc.	New York, N.Y.
AMF, Incorporated	White Plains, N.Y.
Amtel, Inc.	Providence, R.I.
Arcata National Corporation	Menlo Park, Calif.
Aro Corporation, The	Bryan, Ohio
Associated Spring Corporation	Bristol, Conn.
Automation Industries, Inc.	Los Angeles, Calif.
Avco Corporation	Greenwich, Conn.
Bally Manufacturing Corporation	Chicago, Ill.
Cabot, Cabot & Forbes Land Trust	Boston, Mass.
Capital Cities Communications, Inc.	New York, N.Y.
Central Soya Company, Inc.	Fort Wayne, Ind.
Cessna Aircraft Company	Wichita, Kansas
Chesebrough-Pond's, Inc.	Greenwich, Conn.
Collins & Aikman Corporation	New York, N.Y.
Conrac Corporation	New York, N.Y.
Continental Oil Company	Stamford, Conn.
Cooper Tire & Rubber Company	Findlay, Ohio
Cornwall Equities, Ltd.	New York, N.Y.
Denny's, Inc.	La Mirada, Calif.
DPF, Incorporated	Hartsdale, N.Y.
Electronic Data Systems Corporation	Dallas, Texas
Electronic Memories and Magnetics Corp.	Los Angeles, Calif.

AUDIT CLIENTS OF ARTHUR YOUNG & COMPANY WHOSE EQUITY SECURITIES WERE LISTED ON THE N.Y. STOCK EXCHANGE AS OF NOVEMBER 30, 1975*

-2-

Empire District Electric Company	Joplin, Mo.
Equitable Gas Company	Pittsburgh, Pa.
Esmark, Inc.	Chicago, Ill.
Fedders Corporation	Edison, N.J.
Fieldcrest Mills, Inc.	Eden, N.C.
Financial Federation, Inc.	Los Angeles, Calif.
Florida East Coast Railway Company	St. Augustine, Fla.
Fluor Corporation	Los Angeles, Calif.
Gas Service Company, The	Kansas City, Mo.
GCA Corporation	Bedford, Mass.
General Cable Corporation	Greenwich, Conn.
General Instrument Corporation	Newark, N.J.
Giddings & Lewis, Inc.	Fond Du Lac, Wis.
Handleman Company	Detroit, Mich.
Hesston Corporation, Inc.	Heston, Kansas
Heublein, Inc.	Farmington, Conn.
Houghton Mifflin Co.	Boston, Mass.
ICN Pharmaceuticals, Inc.	Irvine, Calif.
Imperial Corporation of America	San Diego, Calif.
INA Corporation	Philadelphia, Pa.
INA Investment Securities, Inc.	Philadelphia, Pa.
International Minerals & Chemical Corporation	Libertyville, Ill.
Interstate Brands Corporation	Kansas City, Mo.
Koppers Company, Inc.	Pittsburgh, Pa.
Lockheed Aircraft Corporation	Burbank, Calif.
Ludlow Corporation	Needham Heights, Mass.
McDonald's Corporation	Oak Brook, Ill.
McGraw Hill, Inc.	New York, N.Y.
Madison Square Garden Corporation	New York, N.Y.
Marathon Manufacturing Co.	Houston, Texas

AUDIT CLIENTS OF ARTHUR YOUNG & COMPANY WHOSE EQUITY SECURITIES WERE LISTED ON THE N.Y. STOCK EXCHANGE AS OF NOVEMBER 30, 1975*

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MBPXL Corp.	Plainview, Texas
Menasco Manufacturing Company	Burbank, Calif.
MGIC Investment Corporation	Milwaukee, Wis.
Microdot, Inc.	Greenwich, Conn.
Mobil Oil Corporation	New York, N.Y.
Montana-Dakota Utilities Co.	Bismarck, N. Dakota
Norton Company	Worcester, Mass.
OKC Company	Dallas, Texas
Overnite Transportation Company	Richmond, Va.
Owens-Illinois, Inc.	Toledo, Ohio
Paine Webber, Incorporated	New York, N.Y.
PepsiCo, Inc.	Purchase, N.Y.
Petrolane, Incorporated	Long Beach, Calif.
Phillips Petroleum Company	Bartlesville, Okla.
Pioneer Corporation	Amarillo, Texas
PNB Mortgage & Realty Investors[1]	Melrose Park, Pa.
Pope & Talbot, Inc.	Portland, Oregon
PSA, Inc.[1]	San Diego, Calif.
Public Service Company of Colorado[3]	Denver, Colorado
Pullman, Incorporated	Chicago, Ill.
RCA Corporation	New York, N.Y.
Reserve Oil and Gas Company[2]	Los Angeles, Calif.
Richmond Corporation	Richmond, Va.
SCA Services, Inc.	Boston, Mass.
Seaboard World Airlines, Inc.	Jamaica, N.Y.
Service Corporation International	Houston, Texas
Sheller Globe Corporation	Toledo, Ohio
Smith, A. O., Corporation	Milwaukee, Wis.
Sonesta International Hotels Corporation	Boston, Mass.

AUDIT CLIENTS OF ARTHUR YOUNG & COMPANY WHOSE EQUITY SECURITIES WERE LISTED ON THE N.Y. STOCK EXCHANGE AS OF NOVEMBER 30, 1975*

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Southern Natural Resources, Inc.	Birmingham, Alabama
Sparton Corporation	Jackson, Mich.
Sperry Rand Corporation	New York, N.Y.
Sterling Precision Corporation	West Palm Beach, Fla.
Suburban Propane Gas Corporation	Whippany, N.J.
Teleprompter Corporation	New York, N.Y.
Texas Instruments, Inc.	Dallas, Texas
Textron, Inc.[1]	Providence, R.I.
Thiokol Corporation	Bristol, Pa.
Todd Shipyards Corp.	New York, N.Y.
Transohio Financial Corporation	Columbus, Ohio
Trinity Industries, Inc.	Dallas, Texas
Tyler Corp.	Dallas, Texas
UMC Industries, Inc.	New York, N.Y.
United Corporation, The	New York, N.Y.
United Telecommunications, Inc.	Kansas City, Mo.
Universal Leaf Tobacco Co., Inc.	Richmond, Va.
Veeder Industries, Inc.	Hartford, Conn.
Walmart Stores, Inc.	Bentonville, Ark.
Warner Communications, Inc.[3]	New York, N.Y.
West Point-Pepperell, Inc.	West Point, Ga.
Western Pacific Industries, Inc.[1]	New York, N.Y.
Williams Companies, Inc.	Tulsa, Okla.
Wrigley W., Jr. Company	Chicago, Ill.
Wyly Corp.	Dallas, Texas

AUDIT CLIENTS OF ARTHUR YOUNG & COMPANY WHOSE EQUITY SECURITIES WERE LISTED ON THE N.Y. STOCK EXCHANGE AS OF NOVEMBER 30, 1975*

FOOTNOTES

*From Commerce Clearing House N.Y. Stock Exchange Guide, January 1976

1. Has Warrants Listed On American Stock Exchange.

2. Also Listed On American Stock Exchange.

3. Has Other Securities Listed on American Stock Exchange.

January 27, 1976

Schedule B

AUDIT CLIENTS OF ARTHUR YOUNG & COMPANY WHOSE EQUITY SECURITIES WERE LISTED ON THE AMERICAN STOCK EXCHANGE AS OF NOVEMBER 28, 1975*

Alan Wood Steel Company	Conshohocken, Pa.
Amerada Hess Corporation[1,2]	New York, N.Y.
Arrow Electronics, Inc.	New York, N.Y.
Avondale Mills	Sylacauga, Alabama
Badger Meter, Inc.	Milwaukee, Wis.
Bannister Continetal Corp.[3]	Mississauga, Ontario, Can.
Basin Petroleum Corp.	Oklahoma City, Okla.
Bertea Corporation	Irvine, Calif.
Beverly Enterprises	Pasadena, Calif.
Bluebird Incorporated	Chicago, Ill.
Burgess Industries, Incorporated	Dallas, Texas
Certified Corp.	Plainville, Mass.
Coffee Mat Corporation	Kenilworth, N.J.
Cohu, Inc.	San Diego, Calif.
Commerce Group Corp.	Milwaukee, Wis.
Computer Investors Group, Inc.	Stamford, Conn.
Condec Corporation	Old Greenwich, Conn.
Corenco Corporation	Tewksbury, Mass.
Cosco, Inc.	Columbus, Ind.
Crutcher Resources Corporation	Houston, Texas
Data Products Corporation	Woodland Hills, Calif.
Eason Oil Company	Oklahoma City, Okla.
Edgington Oil Company	Long Beach, Calif.
Electronic Engineering Company of California	Santa Ana, Calif.
Ernst, E.C., Inc.	Washington, D.C.
Fanny Farmer Candy Shops, Inc.	Bedford, Mass.
FDI, Inc.	Cleveland, Ohio
First Realty Investment Corp.	Miami Beach, Fla.
Firstmark Corporation	Buffalo, N.Y.
Fischer & Porter Company	Warminster, Pa.
Florida Rock Industries, Inc.	Jacksonville, Fla.
Genge, Inc.	Los Angeles, Calif.

AUDIT CLIENTS OF ARTHUR YOUNG & COMPANY WHOSE EQUITY SECURITIES WERE LISTED ON THE AMERICAN STOCK EXCHANGE AS OF NOVEMBER 28, 1975*

-2-

Genisco Technology Corp.	Compton, Calif.
GRI Corp.	Chicago, Illinois
Hemdale Enterprises, Inc.	New York, N.Y.
Huntington Health Services, Inc.	Los Angeles, Calif.
Hycel, Inc.	Houston, Texas
Indian Head, Inc.[1]	New York, N.Y.
Instron Corporation	Canton, Mass.
International Systems and Controls Corporation	Houston, Texas
Kay Corporation	Alexandria, Va.
Lee National Corp.	New York, N.Y.
Lodge & Shipley Company, The	Cincinnati, Ohio
LSB Industries, Inc.	Oklahoma City, Okla.
Mansfield Tire and Rubber Company	Mansfield, Ohio
Marshall Foods, Inc.	Marshall, Minn.
McCulloch Oil Corp.	Los Angeles, Calif.
Media General, Inc.	Richmond, Va.
MEM Company, Inc.	Northvale, N.J.
Mercantile Industries, Inc.	Chicago, Ill.
Midland Glass Co.	Cliffwood, N.J.
Mission Investment Trust	San Diego, Calif.
Mouldings, Inc.[3]	Las Vegas, Nevada
National Bellas Hess, Inc.[3]	North Kansas City, Mo.
National Health Enterprises, Inc.	Santa Monica, Calif.
National Kinney Corp.	New York, N.Y.
New Park Resources	New Orleans, La.
Offshore Co., The	Houston, Texas
Palomar Financial	San Diego, Calif.
Pep Boys - Manny, Moe & Jack, The	Philadelphia, Pa.
PNB Mortgage and Realty Investors[1,2]	Melrose Park, Pa.
Prel Corporation[3]	Saddle Brook, N.J.
Property Capital Trust	Boston, Mass.
PSA, Inc.[1,2]	San Diego, Calif.

AUDIT CLIENTS OF ARTHUR YOUNG & COMPANY WHOSE EQUITY SECURITIES WERE LISTED ON THE AMERICAN STOCK EXCHANGE AS OF NOVEMBER 28, 1975*

-3-

Public Service Company of Colorado[2]	Denver, Colo.
Pulte Home Corporation	West Bloomfield, Mich.
Realty Income Trust	Providence, R.I.
Republic Housing Corp.	Dallas, Texas
Reserve Oil and Gas Company[2]	Apple Valley, Calif.
Sealectro Corporation	Mamaroneck, N.Y.
Southwest Airlines	Dallas, Texas
Stanley Aviation Corp.	Denver, Colo.
Textron, Inc.[1,2]	Providence, R.I.
Timpte Industries, Inc.	Denver, Colo.
Treadway Companies, Inc.	Paterson, N.J.
United States Bancorp Realty and Mortgage Trust	Portland, Oregon
United States Filter Corporation	New York, N.Y.
Unitek Corporation	Monrovia, Calif.
Vikoa, Inc.	New York, N.Y.
Warner Communications, Inc.[2]	New York, N.Y.
Watsco, Inc.	Hialeah, Fla.
Western Pacific Industries, Inc.[1,2]	New York, N.Y.
Wolf, Howard B., Inc.	Dallas, Texas
Wynn's International, Inc.	Fullerton, Calif.
Xonics, Inc.	Van Nuys, Calif.

AUDIT CLIENTS OF ARTHUR YOUNG & COMPANY WHOSE EQUITY SECURITIES WERE LISTED ON THE AMERICAN STOCK EXCHANGE AS OF NOVEMBER 28, 1975*

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FOOTNOTES

*Latest Listing Available From Commerce Clearing House American Stock Exchange Guide, January 1976

1. Warrants are traded.
2. Common shares traded on N.Y. Stock Exchange.
3. Trading in common stock suspended.

January 27, 1976

Schedule C

DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF FEDERAL, STATE AND MUNICIPAL AGENCIES
FOR WHICH ARTHUR YOUNG & COMPANY PERFORMED SERVICES
IN THE YEAR ENDING SEPTEMBER 30, 1975

- 1 -

Client	Location	Department, Agency, Subdivision Or Authorities
State of Alaska	Alaska	Department of Administration
		Courts, Technical Service
		Department of Labor
City of Anchorage		Administration Department
City of Cordova		Audit Client
City of Homer		Audit Client
Kenai Peninsula Borough		Audit Client
City of Kodiak		Audit Client
Matanuska Susikna School District		Superintendent of Schools
		Audit Client
State of Arizona	Arizona	Navajo Economic Opportunity
		Department of Health Services
County of Coconino		County Courts
Town of Benson		Audit Client
Lake Havasu		Irrigation & Drainage District
		Sanitary District
City of Phoenix		Department of Health Services
		Public Library
Scottsdale Public Schools		Board of Education
Sunnyside Public Schools		Board of Education
White Mountain Apache Tribe		
Town of Youngtown		Audit Client
Yuma Union High School District		Board of Education

Schedule C

DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF FEDERAL, STATE AND MUNICIPAL AGENCIES
FOR WHICH ARTHUR YOUNG & COMPANY PERFORMED SERVICES
IN THE YEAR ENDING SEPTEMBER 30, 1975

- 2 -

Client	Location	Department, Agency, Subdivision Or Authorities
State of California	California	Department of Water Resources
		Water Contractors Audit Committee
		Office of Criminal Justice Planning
		Judicial Council
		Health Department
		Employment Development Department
		Health & Welfare, Region VI
County of Coachella Valley		Water District
County of Contra Costa		Director of Planning
County of Humboldt		Department of Public Works
County of Imperial		
County of Los Angeles		Sheriff's Department
		Housing Authority
		Department of Commerce
County of Monterey		Administrative Office
County of Orange		Personnel Department
		Transit District Planning Department
County of Plumas		Road Commission
County of Riverside		Narcotic Impact Team
		Road Department
County of Sacramento		Community Health Department
County of San Joaquin		Department of Public Assistance
County of Santa Barbara		Municipal Court
		Bureau of Alcoholism Service
County of Santa Clara		County Administration Office
		Police Department
County of Trinity		Office of the Superior Court
ABC Unified School District		Board of Education
City of Anaheim		Municipal Council (all departments)
City of Baldwin Park		Police Department
City of Beverly Hills		City Manager's Office
Chaffey Union High School District		Board of Education
City of Costa Mesa		City Manager's Office (Data Proc. operations)
City of Emeryville		
Federal National Mortgage Assoc.		Administration
City of Fremont		Police Department
Garden Grove Unified School Dist.		Dept. of Administrative Management Operations
City of Gilroy		Department of Finance
		Audit Client
Grossmont Union High School District		Personnel Department
City of Los Angeles		Board of Parking Commissioners
		Fire Department
		City Clerk's Office
		Department of Water & Power
		Board of Commissioners
		Data Service Bureau
Los Angeles Unified School District		Board of Education
City of Martinez		City Manager's Office
City of Sacramento		Police Department
City of San Diego		School Board
San Diego Unified School District		Personnel Operations
City of San Francisco		Airport Improvement
City of San Jose		
		Police Department
San Jose Unified School District		Controller's Office
City of San Juan		Audit Client
City of Stockton		Police Department

DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF FEDERAL, STATE AND MUNICIPAL AGENCIES
FOR WHICH ARTHUR YOUNG & COMPANY PERFORMED SERVICES
IN THE YEAR ENDING SEPTEMBER 30, 1975

- 3 -

Client	Location	Department, Agency, Subdivision Or Authorities
State of Connecticut	Connecticut	Committee on Training & Employment
		Statewide Enforcement Coordinating Committee
		State Police
		Welfare Department
City of Hartford		Housing Authority
		Comptroller's Office
City of New Britain		Housing Authority
Town of Southbridge		Town Manager's Office
City of Waterbury		Comptroller's Office
State of Colorado	Colorado	Department of Public Health
		Department of Social Services
County of Denver		Department of Finance
City of Denver		Department of Finance
State of Delaware	Delaware	Courts Administrative Office
State of Florida	Florida	Division of Fund Sales
		Auditor General
NE Florida District No. 1		Mental Health Board
County of Brevard		County Utility System
		County Clerk's Office
County of Dade		Aviation Department
County of Lee		County Administrator's Office
County of Orange		Comptroller's Office
City of Canaveral		Port Authority
City of Jacksonville		Public Health Division
		All Departments
City of Tampa		Office of the Mayor
		Audit Client
		Port Authority
City of Titusville		Audit Client
State of Georgia	Georgia	Department of Human Resources
City of Atlanta		Bureau of Management Services
City of East Point		Housing Authority
State of Hawaii	Hawaii	Department of Health
		Department of Budget & Finance
County of Honolulu		Office of Human Resources
		Department of Public Works
		Department of Parks & Recreation
City of Honolulu		Office of Human Resources
State of Illinois	Illinois	Building Authority
		Housing Development Authority
		Bureau of Employment Security
		Auditor General's Office
		Department of General Services
County of St. Clair		Department of Administration
City of Chicago		Public Building Commission
		Department of Public Works
		Housing Authority
		Board of Health
		Vehicle Recycling Board
		Metropolitan Sanitary District
		Alcoholism Treatment Center
		Comptroller's Office
City of Decatur		Housing Authority
City of Joliet		Housing Authority
City of Peoria		Housing Authority
		Police Department
City of Gary	Indiana	Board of Education
City of Indianapolis		Controller's Office
		Housing Authority
City of South Bend		Housing Authority
City of Excelsior Springs	Kansas	City Clerk's Office
City of Kansas City		Housing Authority
City of New Orleans	Louisiana	District Attorney
		Housing Authority
City of Portland	Maine	Audit Client

DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF FEDERAL, STATE AND MUNICIPAL AGENCIES
FOR WHICH ARTHUR YOUNG & COMPANY PERFORMED SERVICES
IN THE YEAR ENDING SEPTEMBER 30, 1975

- 4 -

Client	Location	Department, Agency, Subdivision Or Authorities
State of Massachusetts	Massachusetts	Committee on Criminal Justice
City of Boston		Housing Authority
		Office of Administrative Services
City of Northboro		Audit Client
State of Michigan	Michigan	Department of Commerce
		Department of State Highways
County of Oakland		Road Commission
City of Pontiac		Housing Commission
State of Minnesota	Minnesota	Supreme Court
		Department of Corrections
County of Anoka		Accounting Office
State of Missouri	Missouri	State Auditor's Office
		Community Health Planning Office
County of Jackson		Court Administrator's Office
		Department of Revenue
County of St. Louis		Audit Client
State of Montana	Montana	Department of Health & Environmental Sciences
State of New Jersey	New Jersey	State Lottery Commission
City of Camden		Housing Authority
City of Buffalo	New York	Audit Client
City of New York		Narcotic Courts
City of Rockville Center		Audit Client
County of Mecklenburg	No. Carolina	Human Resources
		Finance Department
		Audit Client
City of Winston Salem		Housing Authority
State of Ohio	Ohio	Bureau of Employment Services
		Dept. of Health & Mental Retardation
NE Ohio Coordinating Council		Office of Administration
County of Cuyahoga		Court of Common Pleas
		Juvenile Court
County of Lucas		Board of Commissioners
		County Renewal Department
LLoyd County Development Co.		Audit Client
City of Berea		Office of the Mayor
City of Canton		Office of Public Service
		Budget Office
City of Cuyahoga Metropolitan		Housing Authority
City of Cincinnati		Board of Education
		Metropolitan Housing Authority
City of Columbus		Department of Health
City of Toledo		Economic Opportunity Planning Assoc.
Commonwealth Council of Central Okla.	Oklahoma	Planning Office
City of Bartlesville		Audit Client
City of Oklahoma City		Board of Education
		Police Department
County of Multnomah	Oregon	Assessment & Taxation Division
City of Portland		Exposition-Recreation Commission
State of Pennsylvania	Pennsylvania	Department of Justice
		Energy Council
		Public Utility Commission
		Public Parking Authority
County of Fayette-North		Municipal Authority
County of Westmoreland		Labor Relations Office
Borough of Chambersburg		Police Department
Township of Mt. Lebanon		Police Department
City of Pittsburgh		Urban Redevelopment Authority
		Housing Authority
		Regional Personnel Services Center
		Executive Office
		Central Relocation Agency

DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF FEDERAL, STATE AND MUNICIPAL AGENCIES
FOR WHICH ARTHUR YOUNG & COMPANY PERFORMED SERVICES
IN THE YEAR ENDING SEPTEMBER 30, 1975

- 5 -

Client	Location	Department, Agency, Subdivision Or Authorities
State of Rhode Island	Rhode Island	Public Utilities Commission
		Governor's Justice Council
		Court Component Committee
		Department of Economic Development
		Department of Health & Mental Retardation
City of Greenville	So. Carolina	Housing Authority
City of Greer		Housing Authority
City of Laurens		Housing Authority
State of Tennessee	Tennessee	LEAA
State of Texas	Texas	Department of Public Welfare
		Education Agency
North Texas Municipal Water District		Audit Client
Southeast Texas Regional Planning Commission		Director of Criminal Justice
County of Harris		Mental Health & Mental Retardation
County of Kaufman		Municipal Utility District No. 1
County of Tarrant		Water Control & Improvement District No. 1
County of Travis-Commissioners Court		County Judges Office
Alamo Area Council of Governments		Public Health
		Criminal Justice Office
City of Dallas		Water Utilities
		Police Department
		Housing Authorities
City of El Paso		Office of the Mayor
City of Fort Worth		Police Department
		Board of Education
City of Garland		Police Department
City of Houston		Model Cities
		Management Information Services
		Manpower Planning Division
Nassau Bay Homes Assoc., Inc.		Audit Client
City of Robstown		Police Department
Commonwealth of Virginia	Virginia	Office of the Controller
		Office of the Governor
		Governor's Manpower Services Council
		Division of Justice & Crime Prevention
		Department of Justice
City of Richmond		Richmond Area Manpower Council
State of Washington	Washington	Board For Community College Education
		Commission for Vocational Education
		Department of Ecology
		Coordinating Council for Occupational Education
		Department of Motor Vehicles
		Department of Employee Security
		Department of Engineering
		Department of Social and Health Services
		Republican Caucus
County of King		Courthouse Administrative Office
County of Yakima		County Courts
		Treasurer's Department
Federal Way School District		Department of Human Resources
City of Seattle		Manamgenet Information Services
		Public Defender's Office
		General Services Departments
		Department of Parks & Recreation
		Department of Budget & Program Planning

Schedule C

DEPARTMENTS, AGENCIES OR SUBDIVISIONS OF FEDERAL, STATE AND MUNICIPAL AGENCIES
FOR WHICH ARTHUR YOUNG & COMPANY PERFORMED SERVICES
IN THE YEAR ENDING SEPTEMBER 30, 1975

- 6 -

Client	Location	Department, Agency, Subdivision Or Authorities
District of Columbia	Washington,DC	Police Department
State of Wisconsin	Wisconsin	Housing Authority
		Division of Aging
		Department of Administration
		Insurance Commissioner
County of Brown		Housing Authority
County of Kenosh		Director of Planning & Research
City of Madison Public School		Board of Education
City of Milwaukee		Courts
		Sewage Commission
		Controller's Office
City of Wauwatosa		Board of Education
City of West Allis		Board of Education
Overseas Private Investment Corp.	New York	Federal Audit Client
Federal Government	Washington,DC	HEW, Region IX
		Federal Energy Administration
		Environmental Protection Agency
		Railroad Administration
		OSHA
		Energy Research & Development
		National Academy of Science
		Health Planning & Resources Development
		HEW, Public Health Services, Region IX
		Bureau of Quality Assurance (DHEW)
		NHTSA, DOT
		Teachers Corps
		National Oceanographic & Atmospheric Admin.
		Health Services Administration
		Bureau of Community Health Services
		Social Security Administration
		House of Representatives (HIS)
		Federal Highway Administration
		HUD, Office of Policy Development
		Department of Labor
		Assistant Secretary of Defense (Health & Environment)
		HEW, Alcohol, Drug Abuse Administration
		HEW, Social Rehabilitation Services
		ICC, Rail Planning Services Office
		HUD, Housing Management
		LEAA, Information Services
		HEW, Comprehensive Health Planning
		FDIC
		DOT, Transportation Safety Institute
		Environmental Research & Development Administration
		Office of Education (DHEW)
		Federal Railroad Administration
		National Institutes of Health (DHEW)

Schedule D

DEPARTMENTS, AGENCIES, SUBDIVISIONS OR AUTHORITIES
FOR WHICH ARTHUR YOUNG & COMPANY PERFORMED SERVICES
DURING EACH YEAR FROM JANUARY 1, 1970 THROUGH DECEMBER 31, 1974

Year(s)	Client
1974	Environmental Protection Agency
1974	Federal Energy Administration
1974	Social & Rehabilitation Service, DHEW
1974	Federal Power Commission
1973,74	Department of Transportation
1973,74	Department of Agriculture
1971	Department of the Air Force
1971	Army Corps of Engineers
1970,71	Department of the Army
1971	Office of Management & Budget
1974	Department of Commerce
1970,71	Office of the Secretary of Defense
1973,74	Office of Education, DHEW
1972,73	The Office of the White House
1972	Federal Judicial Center
1971,72,73	Agency for International Development
1970,71,72	General Services Administration
1972,73,74	Department of Health, Education & Welfare
1973,74	Health Services & Mental Health Administration, DHEW
1973,74	Department of Housing & Urban Development
1973,74	Department of the Interior
1973,74	Department of Labor
1972,73,74	Law Enforcement Assistance Administration, DOJ
1973	U.S. Marine Corps
1970,71,72	National Bureau of Standards, DOC
1974	National Highway Traffic Safety Administration, DOT
1973,74	National Institutes of Health, DHEW
1973	National Park Service, DOI
1970,71	Department of the Navy
1972	Small Business Administration

COOPERS & LYBRAND
1251 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10020

PHILIP L. DEFLIESE
MANAGING PARTNER

January 13, 1976

Hon. Lee Metcalf, Chairman
Subcommittee on Reports,
Accounting and Management
U. S. Senate
161 Russell Building
Washington, D. C. 20510

Dear Senator Metcalf:

This is in response to your letter of 19 December 1975 requesting the completion of a questionnaire regarding certain information and statistics relative to Coopers & Lybrand.

Coopers & Lybrand respects the right of a Congressional committee, in the exercise of its responsibility, to obtain such information from the private sector as it may need to fulfill its legislative functions. The Firm intends to cooperate with your subcommittee and complete your questionnaire as soon as it can do so practicably.

Some of the information you request is of a nature that is not generally made public with respect to private professional firms. Consequently, we would like to request that the responses to your questionnaires remain confidential with your staff. It would seem to us that appropriate summarizations without identifications should serve your subcommittee's purpose as well as any other.

Some of the information requested is of a nature that is not ordinarily maintained on an ongoing basis at our national headquarters. Consequently, it will take some time for the data to be gathered from all our offices; however, we shall pursue the matter diligently.

We would appreciate one clarification regarding the questionnaire. We note that questions 15 and 16, relating to the same class of services, are not consistent with respect to the period of time covered (i.e., 5 years vs. 6 years). Please advise whether this difference is intentional.

Hon. Lee Metcalf January 13, 1976

We assume that question 7 relates to the latest fiscal year of the Firm only.

Very truly yours,

Philip L. Defliese
Managing Partner

PLD:dem

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

20 January 1976

Mr. Philip L. Defliese
Managing Partner
Coopers & Lybrand
1251 Avenue of the Americas
New York, New York 11020

Dear Mr. Defliese:

Your letter of 13 January requests clarification of this subcommittee's questionnaire on accounting, as well as confidential treatment for some of the information in your firm's response.

Question 7 refers to the latest fiscal year, however, similar data for each of the past five years would be of assistance to the subcommittee. Question 15 does not request 1975 data because that information is covered by question 14.

As a general policy, this subcommittee does not collect information for the confidential use of its members and staff. Information collected is of the type which should properly be in the public domain so that Congress and the public may be informed. The accounting questionnaire was specifically designed to avoid information which might be sensitive or affect the competitive standing of a firm.

If your firm believes that some of the information is confidential, please indicate those sections on your response. While I cannot pledge confidentiality, I can

Mr. Philip L. Defliese
20 January 1976
Page Two

assure you that none of the designated information will be made public without prior discussion with you or a representative of your firm whom you may wish to designate for this purpose.

Very truly yours,

ORIGINAL SIGNED BY
LEE METCALF

COOPERS & LYBRAND
1251 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10020

PHILIP L. DEFLIESE
MANAGING PARTNER

February 19, 1976

Hon. Lee Metcalf, Chairman
Subcommittee on Reports,
Accounting and Management
U. S. Senate
161 Russell Building
Washington, D. C. 20510

Dear Senator Metcalf:

We are pleased to submit herewith the completed questionnaire in accordance with your request.

In line with your suggestion, we have indicated those responses our Firm considers to be of a confidential nature and appreciate the assurance you have given us that none of this designated information will be made public without prior discussion with us.

Very truly yours,

Philip L. Defliese

Philip L. Defliese
Managing Partner

PLD:emc

Enclosure

Coopers & Lybrand

Response to Questionnaire

Submitted to

Hon. Lee Metcalf, Chairman

Subcommittee on
Reports, Accounting & Management
Committee on Government Operations

February 19, 1976

Coopers & Lybrand

Responses to Questionnaire

Question #1

Number of Offices within United States: 81

Question #2

Number of states, territories, possessions of U.S. where Firm maintains Offices: 36

Question #3

Number of cities outside U.S. where Firm maintains Offices or has affiliations: 242

Question #4

Number of partners in Firm located in U.S. (certified public accountants only): 521

Question #5

Number of principals located in Offices in U.S. who are not certified public accountants: 44

Question #6 Confidential

Total number of employees of Firm within U.S., excluding partners and principals: 6,189

Question #7 Confidential

Approximate percentage of total revenues for services performed in the following categories, Fiscal 1975:

A. Auditing and Accounting	69.0%
B. Tax Services	19.0
C. Management Advisory Services	10.0
D. Actuarial	2.0
	100.0%
E. Federal, State, and Local Govt. (included in the above 4 areas of service)	2.0%

Question #8

Categories in which Firm renders management or other advisory services:

A. Executive Recruitment:	Yes
B. Marketing Analysis:	Yes (Minimal)
C. Plant Layout:	Yes (Minimal)
D. Product Analysis:	No
E. Actuarial Services:	Yes
F. Federal Advisory Committees: At the present time, a member of our Firm, Mr. Frank Grey, Philadelphia, is serving as a member of the SEC Advisory Committee on Real Estate.	Yes

Question #9

Corporations listed on New York Stock Exchange for which Firm is independent auditor: See List Attached

Question #10

Corporations listed on American Stock Exchange for which Firm is independent auditor: See List Attached

Question #11 Confidential

Number of other publicly held corporations for which Firm is independent auditor: 561

Number of privately held corporations for which Firm is independent auditor: 4877 (excluding subsidiaries)
7382 (including subsidiaries of privately held corporations and subsidiaries of publicly held companies not separately traded)

Question #12

Total number of partners, principals and employees who are members of American Institute of Certified Public Accountants: 2,280

Question #13

Contributions to Financial Accounting Standards Board:

The following payments were made to the Accounting Research Association to be passed on to the Financial Accounting Foundation to support the Financial Accounting Standards Board:

Calendar Year	Amount
1972	$ 90,000
1973	150,000
1974	200,000
1975	200,000
1976 (to date)	50,000

Question #14

Government agencies for whom Firm performed services during 1975: See List Attached

Question #15

Federal entities for whom Firm performed services during calendar years 1970 through 1974: See List Attached

Question #16 Confidential

Annual gross revenues for services performed for federal entities during calendar years 1970 through 1975: See List Attached

Question #17

The Firm does not maintain a department, division or office for the procurement of Federal, State and local government contracts. However, we do have certain persons who are involved in responding to Government RFP's.

ANSWER TO QUESTION #9

COOPERS AND LYBRAND CLIENTS
LISTED ON
NEW YORK STOCK EXCHANGE

AMAX, Inc.	New York, N.Y.
ASARCO, Inc.	New York, N.Y.
Adams Express Co.	New York, N.Y.
Albany International Corp.	Albany, N.Y.
Allen Group, Inc.	Melville, N.Y.
Allied Maintenance Corp.	New York, N.Y.
Aluminum Company of America	Pittsburgh, Pa.
Amalgamated Sugar Co.	Ogden, Utah
American Brands, Inc.	New York, N.Y.
American Can Co.	Greenwich, Conn.
American Telephone and Telegraph Co.	New York, N.Y.
Armada Corp.	Detroit, Mich.
Atico Mortgage Investors	Miami, Fla.
Atlantic Richfield Co.	Los Angeles, Calif.
Atlas Corp.	New York, N.Y.
Baltimore Gas and Electric Co.	Baltimore, Md.
Barber Oil Corp.	New York, N.Y.
Barnett Mortgage Trust	Jacksonville, Fla.
Boston Edison Co.	Boston, Mass.
Brown & Sharpe Manufacturing Co.	North Kingstown, R.I.
CBS, Inc.	New York, N.Y.
CCI Corporation	Tulsa, Okla.
CNA-Larwin Investment Company	New York, N.Y.
Cabot Corp.	Boston, Mass.
Callahan Mining Corp.	Darien, Conn.
Capital Mortgage Investments	Chevy Chase, Md.
Carpenter Technology Corp.	Reading, Pa.
Carriers & General Corp.	New York, N.Y.
Central Louisiana Electric Company	Alexandria, La.
Chesapeake Corporation of Virginia	West Point, Va.
Cincinnati Bell, Inc.	Cincinnati, Ohio
Colonial Penn Group, Inc.	Philadelphia, Pa.
ConAgra, Inc.	Omaha, Neb.
Continental Copper & Steel Ind., Inc.	New York, N.Y.
Copper Range Co.	White Pine, Mich.
Crouse-Hinds Co.	Syracuse, N.Y.
Crown Zellerbach Corp.	San Francisco, Calif.
Curtiss-Wright Corp.	Woodridge, N.J.
Cyprus Mines Corp.	Los Angeles, Calif.
Damon Corp.	Needham Heights, Mass.

Coopers and Lybrand Client: New York Stock Exchange (continued)

Delmarva Power & Light Co.	Wilmington, Del.
Dexter Corp.	Windsor Locks, Conn.
Dictaphone Corp.	Rye, N.Y.
Digital Equipment Corp.	Maynard, Mass.
Diversified Industries, Inc.	Clayton, Mo.
Dun & Bradstreet Companies, Inc.	New York, N.Y.
Duplan Corp.	Winston-Salem, N.C.
Emery Industries, Inc.	Cincinnati, Ohio
Ethyl Corp.	Richmond, Va.
Fidelity Mortgage Investors	Jacksonville, Fla.
Firestone Tire & Rubber Co.	Akron, Ohio
First National Boston Corp.	Boston, Mass.
Flintkote Co.	White Plains, N.Y.
Ford Motor Co.	Dearborn, Mich.
Freeport Minerals Co.	New York, N.Y.
Garfinkel, Brooks Bros., Miller & Rhoads, Inc.	Washington, D.C.
General Growth Properties	Des Moines, Iowa
General Public Utilities Corp.	New York, N.Y.
General Refractories Co.	Bala-Cynwyd, Pa.
Genstar Ltd.	Montreal, Canada
Global Marine, Inc.	Los Angeles, Calif.
Guardian Industries Corp.	Northville, Mich.
Gulf States Utilities Co.	Beaumont, Tex.
HMW Industries, Inc.	Stamford, Conn.
Hammond Corp.	Chicago, Ill.
Harsco Corp.	Camp Hill, Pa.
Hecla Mining Co.	Wallace, Idaho
Helene Curtis Industries, Inc.	Chicago, Ill.
Hemisphere Fund, Inc.	New York, N.Y.
Hercules, Inc.	Wilmington, Del.
High Voltage Engineering Corp.	Burlington, Mass.
Horizon Corp.	Tucson, Ariz.
Humana, Inc.	Louisville, Ky.
International Rectifier Corp.	Los Angeles, Calif.
Interstate United Corp.	Chicago, Ill.
Jersey Central Power & Light Co.	Morristown, N.J.
Johns-Manville Corp.	Denver, Colo.
Johnson & Johnson	New Brunswick, N.J.
Kennecott Copper Corp.	New York, N.Y.
Keystone Consolidated Industries, Inc.	Peoria, Ill.
Kroger Co.	Cincinnati, Ohio
Lane Bryant, Inc.	New York, N.Y.
Leeds & Northrup Co.	North Wales, Pa.
Lehigh Valley Industries, Inc.	New York, N.Y.
Lone Star Industries, Inc.	Greenwich, Conn.
Loral Corp.	New York, N.Y.

Lynch Communication Systems,Inc.	San Francisco, Calif.
MacAndrews & Forbes Co.	Philadelphia, Pa.
Madison Fund, Inc.	Wilmington, Del.
Manhattan Industries, Inc.	New York, N.Y.
Martin Marietta Aluminum, Inc.	Washington, D.C.
Maryland Cup Corp.	Owings Mills, Md.
Masco Corp.	Taylor, Mich.
Mass. Mutual Corporate Investors, Inc.	Springfield, Mass.
Mass. Mutual Income Investors, Inc.	Springfield, Mass.
Mass. Mutual Mortgage and Realty Investors	Springfield, Mass.
Metropolitan Edison Company	Reading, Pa.
Mid-Continent Telephone Corp.	Hudson, Ohio
Milton Bradley Co.	Springfield, Mass.
Minnesota Mining and Manufacturing	St. Paul, Minn.
Mission Equities Corp.	Los Angeles, Calif.
Monarch Machine Tool Co.	Sidney, Ohio
Morrison-Knudsen Company, Inc.	Boise, Idaho
Mountain States Telephone and Tel. Co.	Denver, Colo.
Murphy Co., G.C.	McKeesport, Pa.
N.L. Industries, Inc.	New York, N.Y.
Nabisco, Inc.	New York, N.Y.
National Presto Industries,Inc.	Eau Claire, Wis.
New England Electric System	Westborough, Mass.
New England Mutual Life Insurance Co.	Boston, Mass.
New England Telephone and Telegraph Co.	Boston, Mass.
New York State Electric & Gas Corp.	Ithaca, N.Y.
Oakite Products, Inc.	Berkeley Heights, N.J.
Orange Co., Inc.	Columbus, Ohio
Pacific Telephone & Telegraph Co.	San Francisco, Calif.
Pacific Tin Consolidated Corp.	New York, N.Y.
Pan American World Airways, Inc.	New York, N.Y.
Parker-Hannifin Corp.	Cleveland, Ohio
Petroleum Corporation of America	New York, N.Y.
Philadelphia Electric Co.	Philadelphia, Pa.
Philip Morris, Inc.	New York, N.Y.
Planning Research Corp.	Los Angeles, Calif.
Playboy Enterprises, Inc.	Chicago, Ill.
Proler International Corp.	Houston, Tex.
Puget Sound Power & Light Co.	Bellevue, Wash.
Quaker State Oil Refining Corp.	Oil City, Pa.

Ramada Inns, Inc.	Phoenix, Ariz.
Ranco, Inc.	Columbus, Ohio
Raytheon Co.	Lexington, Mass.
Reading & Bates Offshore Drilling Co.	Tulsa, Okla.
Revere Copper and Brass, Inc.	New York, N.Y.
Rorer-Amchem, Inc.	Fort Washington, Pa.
Royal Crown Cola Co.	Atlanta, Ga.
Savannah Electric and Power Co.	Savannah, Ga.
Savin Business Machines Corp.	Valhalla, N.Y.
Scoa Industries, Inc.	Columbus, Ohio
Scott & Fetzer Co.	Lakewood, Ohio
Scudder Duo-Vest, Inc.	New York, N.Y.
Sierra Pacific Power Co.	Reno, Nev.
Simmons Co.	Atlanta, Ga.
Skyline Corp.	Elkhart, Ind.
Southern New England Telephone Co.	New Haven, Conn.
Sterndent Corp.	Mt. Vernon, N.Y.
Stokely-Van Camp, Inc.	Indianapolis, Inc.
Stone & Webster, Inc.	New York, N.Y.
Storer Broadcasting Co.	Miami Beach, Fla.
Stride Rite Corp.	Boston, Mass.
Sun Oil Co.	St. Davids, Pa.
Sunshine Mining Co.	Kellogg, Idaho
Swank, Inc.	Attleboro, Mass.
Talcott National Corp.	New York, N.Y.
Talley Industries, Inc.	Mesa, Ariz.
Tampa Electric Co.	Tampa, Fla.
Telex Corp.	Tulsa, Okla.
Transway International Corp.	New York, N.Y.
Travelers Corp.	Hartford, Conn.
UGI Corp.	Valley Forge, Pa.
USM Corp.	Boston, Mass.
UV Industries, Inc.	New York, N.Y.
Union Corp.	Verona, Pa.
Union Oil Company of California	Los Angeles, Calif.
United Illuminating Co.	New Haven, Conn.
United Refining Co.	Warren, Pa.
United States Fidelity and Guaranty Co.	Baltimore, Md.
Unitrode Corp.	Watertown, Mass.
Upjohn Co.	Kalamazoo, Mich.
Varian Associates	Palo Alto, Calif.
Viacom International, Inc.	New York, N.Y.
Virginia Electric and Power Co.	Richmond, Va.
Washington Steel Corp.	Washington, Pa.
Weis Markets, Inc.	Sunbury, Pa.
Western Publishing Company, Inc.	Racine, Wis.
Whittaker Corp.	Los Angeles, Calif.
Wickes Corp.	San Diego, Calif.
World Airways, Inc.	Oakland, Calif.
Zayre Corp.	Framingham, Mass.

ANSWER TO QUESTION #10

COOPERS AND LYBRAND CLIENTS LISTED ON AMERICAN STOCK EXCHANGE

AVX Corp.	Great Neck, N.Y.
Airpax Electronics, Inc.	Fort Lauderdale, Fla.
Alcolac, Inc.	Baltimore, Md.
Amco Industries, Inc.	Franklin Park, Ill.
American International Pictures	Beverly Hill, Calif.
American Maize-Products Co.	New York, N.Y.
American Realty Trust	Arlington, Va.
Anixter Bros.,Inc.	Skokie, Ill.
Baldwin Securities Corp.	New York, N.Y.
Bancroft Convertible Fund,Inc.	New York, N.Y.
Binney & Smith, Inc.	New York, N.Y.
Blount, Inc.	Montgomery, Ala.
Bolt Beranek and Newman, Inc.	Cambridge, Mass.
Brown-Forman Distillers Corp.	Louisville, Ky.
CSE Corp.	San Francisco, Calif.
Campbell Industries	San Diego, Calif.
Caressa, Inc.	Miami, Fla.
Carrols Development Corp.	Syracuse, N.Y.
Chemical Express Co.	Dallas, Tex.
Citizens Financial Corp.	Cleveland, Ohio
Coit International, Inc.	Dallas, Tex.
Combustion Equipment Associates, Inc.	New York, N.Y.
Compudyne Corp.	Chicago, Ill.
Conrock Co.	Los Angeles, Calif.
Consolidated Oil & Gas, Inc.	Denver, Colo.
Continental Materials Corp.	Chicago, Ill.
Corroon & Black Corp.	New York, N.Y.
Curtis Mathes Corp.	Athens, Tex.
DCL, Inc.	Englewood, N.J.
Data-Control Systems, Inc.	Danbury, Conn.
ELT, Inc.	Cherry Hill, N.J.
Earth Resources Co.	Dallas, Tex.
Eastern Co.	Westwood, Mass.
Egan Machinery Co.	Somerville, N.J.
First Connecticut Small Business	Bridgeport, Conn.
Flying Diamond Oil Corp.	Denver, Col.
Fresnillo Co.	New York, N.Y.
Gilbert Companies, Inc.	Columbus, Ohio
Glenmore Distilleries Co.	Louisville, Ky.
Grand Central, Inc.	Salt Lake City, Utah

C&L Clients - American Stock Exchange (continued)

Great American Industries, Inc.	New York, N.Y.
Great Lakes Recreation Co.	Southfield, Mich.
Greit Realty Trust	Drexel Hill, Pa.
Gruen Industries, Inc.	New York, N.Y.
Heinicke Instruments Co.	Hollywood, Fla.
House of Vision, Inc.	Chicago, Ill.
Inolex Corporation	Chicago, Ill.
Investors Funding Corp.	New York, N.Y.
Ionics, Incorporated	Watertown, Mass.
Jeannette Corp.	Jeannette, Pa.
Kit Manufacturing Co.	Long Beach, Calif.
Lane Wood, Inc.	Dallas, Tex.
Latouraine-Bickford's Foods, Inc.	Newton, Mass.
Macrodyne Industries, Inc.	Los Angeles, Calif.
Manhattan Life Corp.	New York, N.Y.
Maule Industries, Inc.	Miami, Fla.
Milgo Electronics Corp.	Miami, Fla.
Mite Corp.	New Haven, Conn.
Moamco Corp.	Minneapolis, Minn.
Nelly Don, Inc.	North Kansas City, Mo.
New Hampshire Ball Bearings, Inc.	Peterborough, N.H.
Newcor, Inc.	Bay City, Mich.
On-Line Systems, Inc.	Pittsburgh, Pa.
Oxford First Corp.	Philadelphia, Pa.
Pacific Northwest Bell Telephone Co.	Seattle, Wash.
Pandel-Bradford, Inc.	Lowell, Mass.
Pratt-Read Corp.	Ivoryton, Conn.
Punta Gorda Isles, Inc.	Punta Gorda, Fla.
Putnam's Sons, G.P.	New York, N.Y.
Research-Cottrell, Inc.	Bound Brook, N.J.
Rex-Noreco, Inc.	Englewood Cliffs, N.J.
Rio Algom Mines Ltd.	Ontario, Toronto
Rockwood National Corp.	Elmsford, N.Y.
Rogers Corp.	Rogers, Conn.
Ryan Homes, Inc.	Pittsburgh, Pa.
SGL Industries, Inc.	Haddonfield, N.J.
Saunders Leasing System, Inc.	Birmingham, Ala.
Scope Industries	Los Angeles, Calif.
Seligman & Associates, Inc.	Southfield, Mich.
Shearson Hayden Stone, Inc.	New York, N.Y.
Splentex, Inc.	New York, N.Y.
Stelber Industries, Inc.	Valley Stream, N.Y.
Systems Engineering Laboratories, Inc.	Fort Lauderdale, Fla.
TFI Industries, Inc.	Chicago, Ill.
Tasty Baking Co.	Philadelphia, Pa.

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C&L Clients - American Stock Exchange (continued)

Telecom Corp.	Houston, Tex.
Teradyne, Inc.	Boston, Mass.
Tokheim Corp.	Fort Wayne, Ind.
Turner Construction Co.	New York, N.Y.
U.S. Natural Resources, Inc.	Menlo Park, Calif.
United Aircraft Products, Inc.	Dayton, Ohio
Wagner Electric Corp.	Parsippany, N.J.
Welded Tube Company of America	Philadelphia, Pa.
Worcester Controls Corp.	West Boylston, Mass.
Wyomissing Corp.	West Reading, Pa.

ANSWER TO QUESTION #14

GOVERNMENT AGENCIES FOR WHOM SERVICES WERE PERFORMED DURING 1975

I. FEDERAL ENTITIES

Army Armaments Command

Bureau of Mines, Interior

Bureau of Quality Assurance, HEW

Drug Enforcement Agency

Federal Aviation Administration

Federal Home Loan Bank Board

Federal Reserve Bank

House of Representatives, Office of Information Systems

Housing and Urban Development, Department of

Interstate Commerce Commission

Law Enforcement Assistance Administration

National Institute of Health

Navy, Department of

Office of the Secretary of Defense

Postal Service

Social and Rehabilitation Service, HEW

Smithsonian Institution

II. STATE ENTITIES

Alabama	-	ABC Board
Alaska	-	Legislative Council
	-	Native Foundation
	-	Native Fund
California	-	Community College District, Los Rios
	-	Employee Contingency Reserve Fund
	-	Old Age and Survivors Insurance Fund
	-	Legislators Retirement Fund
	-	Public Buildings Construction Fund
	-	Exposition Revenue Bonds
	-	Rapid Transit District, Southern California
	-	Teachers Retirement System
	-	Public Employees Retirement System
Colorado	-	Housing Finance Authority
Florida	-	Department of Transportation
Georgia	-	Residential Finance Agency
Gulf States	-	Marine Fisheries Commission
Hawaii	-	Department of Agriculture
	-	Department of Transportation
	-	Legal Aid Society
	-	Special Compensation Fund
Indiana	-	Senate

Kentucky	-	Department of Highways
	-	Pollution Abatement Authority
Louisiana	-	Information Processing Agency
	-	Health and Human Resource Administration
	-	Housing Finance Authority
Maine	-	State of
Maryland	-	Community Development Administration
	-	Department of Budget and Fiscal Planning
	-	Department of Fiscal Services
	-	Department of Education
	-	Department of Employment and Social Services
	-	Department of Transportation
	-	Department of Vocational Rehabilitation
	-	General Assembly Pension Study Committee
	-	Housing Fund
	-	Industrial Development Authority
	-	Department of Human Resources
Massachusetts	-	Port Authority
	-	Rehabilitation Commission
	-	Housing and Finance Authority
Michigan	-	Workers Compensation Agency
Minnesota	-	Housing Finance Agency
	-	Higher Education Facilities Authority
	-	Higher Education Coordination Commission
Missouri	-	State Auditor
	-	Housing Development Commission
	-	Bi-State Development Agency

QUESTION #14 (continued)

New Jersey	-	Health Maintenance Organization
New York	-	Health Research, Inc.
	-	Roswell Park Housing Authority
	-	Legislative Bill Drafting Committee
Ohio	-	Department of Public Welfare
	-	Housing Development Board
Oklahoma	-	Housing Finance Authority
Oregon	-	Filbert Control Board
Puerto Rico	-	Data Processing Agency
	-	Youth Action Administration
South Dakota	-	Housing Development Authority
Texas	-	Advisory Commission on Intergovernmental Relations
Vermont	-	Insurance Department
Virginia	-	Housing Development Authority
	-	Ports Authority
Washington	-	Department of Fisheries
	-	Legislature
	-	School Bus System
	-	State College, Eastern Washington
	-	Community College District

University of Alaska
University of California Medical Center
University of Redlands, California
University of Hawaii
University of Idaho
University of Kentucky
University of Massachusetts
University of Vermont
University of Washington

II. LOCAL ENTITIES

Abington School District Authority, Pa.

Acalanes Union High School District, Calif.

Acme Improvement District, West Palm Beach, Fla.

Alameda County, Calif.

Allen County, Ind. Economic Opportunity Council

American Museum of Natural History, NY.

Amity Township Police Pension Fund, Pa.

Anchorage, Alas.

Anne Arundel County, Md.

Arnold, Mo.

Avon Township, Mich.

Baldwinsville, NY Central School District

Bangor, Me.Airport

Barrett Township, Pa. Police Pension Fund

Barrow, Alas.

Bay State Professional Services Review Organization, Mass.

Bel-Aire Col. Sanitation District

Bellaire, Tex.

Bensalem School District

Bering Straits Native Corp. Alas.

Berrien County, Mich. Building Authority

Berrien County, Mich. Road Commission

Binghamton, NY General Hospital

Binghamton, NY Model Cities Program

Birmingham, Ala.

Birmingham, Mich.

Bloomfield Hills, Mich. School District

Boca Raton, Fl.

Boston, Mass.

Boyd County, Ky.

Bridgman, Mich. (City and Water Supply System)

Broward County, Fl.

Broward County, Fl. Manpower Council

Buchanan Township, Mich.

Buffalo County, Neb.

Byron, Ga.

Campbell County, Va. Schools

Campbell, Ca.

Carlton, Or.

Carthage, NY Area Hospital

Cascade Locks, Or. (City and Urban Renewal Agency)

Cass County, Mich. Road Commission

Central New York Regional Transportation Authority

Central Ohio Transit Authority

Charlotte, NC OEO Grant

Charlotte and Mecklenburg County, NC Hospital Authority

Charlotte and Mecklenburg County, NC Public Library

Chartiers, Pa. Sanitary Authority

Chester Housing Authority, Pa.

Cincinnati Council on Aging

Cincinnati Model Cities Agency

City of Industry, Los Angeles

Civic Improvement Corp. Phoenix, Ariz.

Civic Plaza Building Corp. Phoenix, Ariz.

Clackamas County, Or. (City, CAA and Service District)

Cleveland, Oh. Criminal Justice Coordinating Council

Columbia, Or. Regional Association of Governments

Columbus, Oh. Legal Services Corporation

Columbus, Oh. Model Cities Agency

Columbus, Oh. Revenue Sharing Agencies

Community Fire Protection District, St. Louis County, Mo.

Concord, Ind. School Township Building

Corbett, Or. School District

Cordova, Ala.

Corning, NY School District

Corvallis, Or. School District

Cranberry, Pa. Municipal Sewer and Water Authority

Culpeper, Va.

Culpeper County, Va. Schools

Dade County, Fl. School District

Darien, Conn.

Dayton, Oh. Joint Township Hospital

Delaware County, Pa. Community College

Detroit, Mich. Housing Authority

Detroit-Wayne Joint Building Authority, Mich.

Dillingham School District, Alas.

Douglas County, Neb.

DuPage County, Ill.

Durham, Or.

East Bay Regional Park District, Calif.

East Pennsylvania Nursing Home

E. C. Glass High School Funds, Lynchburg, Va.

Edwardsburg, Mich. Public Schools

Elkhart, Ind. High School Building Corp.

Elk Grove, Calif. Unified School District

Elkton, Or.

Elmira Heights, NY School District

Eugene, Or. (City and Water and Electric Board)

Everett, Wa.

Fairfax County, Va.

Fannin County, Ga. Hospital

Fauquier County, Va. Hospital

Flagstaff, Ariz. Housing Authority

Flint, Mich.

Florida Keys Aqueduct Authority

Florissant, Mo.

Fort Wayne, Ind. Legal Services Program

Framingham, Mass.

Fulton County, Pa. Medical Center

Gresham, Or.

Grosse Point Farms, Mich.

Grosse Point Park, Mich.

Grosse Point Woods, Mich.

Guadalupe Valley, Calif. Improvement District

Hamilton, NY Memorial Hospital

Hampton, Va.

Harris County, Tex.

Harris Hospital, Fort Worth, Tex.

Hartsville, N.C City and Water Commission

Hatboro, Pa.

Hillsboro Beach, Fl.

Hillsboro, Fl. Community Services Administration

Honolulu, Haw. Board of Water

Honolulu City and County, Hawaii

Hononegah, Ill. School District

Horseheads, NY School District

Houston, Tex. Housing Authority

Howard, Mich.

Hurley Medical Center, Flint, Mich.

Huron Valley, Mich. Public Schools

Huntington Beach, Calif.

Ipswich, Mass.

Jacksonville, Fl.

Jamesville-Dewitt NY Central School District

Kamehameha Schools, Honolulu

Kauai County Water Board, Hawaii

Ken Carly, Col. Water and Sanitation District

Kiski, Pa. Area School Authority

Konia Regional Corp. Alas.

Lanai, Hawaii Community Hospital

Lancaster, Pa.

Lane, Or. Regional Air Pollution Authority

Las Virgenes, Calif. Municipal Water District

Lexington, Ky.Housing Authority

Lincoln Heights, Oh.

Lincoln Park, Mich. Housing Commission

Livonia, Mich.

Long Beach, Calif. Community Hospital

Los Angeles, Calif. Board of Education

Los Angeles, Calif. Community College District

Los Angeles, Calif. Department of Airports

Los Angeles, Calif. Grand Jury

Los Angeles, Calif. Harbor Department

Los Angeles, Calif. Memorial Coliseum

Louisville, Ky

Louisville and Jefferson County Air Board

Lower Merion, Pa. School District

Lower Pioneer Regional Transit Authority, Springfield, Mass.

Mackinac, Mich. Bridge Authority

Maui County, Hawaii

Maui, Hawaii United Way

Maui, Hawaii Memorial Hospital

Maui, Hawaii Water Board

Melvindale-Northern Allen Park, Mich. School District

Metropolitan Area Planning Council, Boston, Mass.

Metropolitan Service District, Portland, Or.

Miami-Dade Water and Sewer Authority

Miami Shores, Fl.

Miami Valley, Ohio Regional Transit Authority

Mid-Peninsula Coalition Housing, Palo Alto, Calif.

Milwaukie, Or.

Mishawaka, Ind.

Monongahela General Hospital

Morris County Library System

Mount Vernon, NY

Multnomah County, Or.

Murphy-Blair Housing Development, St. Louis, Mo.

Murray, Utah

Museum of Science and Natural History, St. Louis, Mo.

Neshaminy School District, Pa.

Newark, NJ

Newark, NJ Housing Authority

New Orleans, La. Housing Authority

New York City Housing Authority

New York Regional Planning Association

Niles, Mich. (City and Board of Public Works)

Norfolk, Va.

North Broward, Fl. Hospital District

North Clackamas, Or. School District

North Dearborn Heights, Mich. School District

North Kingston, RI

North Miami, Fl.

Northwestern Palm Beach Hospital District, Fl.

Norwalk, Conn.

Oakland, Calif.

Oakland, Calif. Port Authority

Orlando, Fl. Central City Development Board

Orlando, Fl. Housing Authority

Oronoko, Mich.

Palm Beach, Fl. Health Planning Council

Parkview Memorial Hospital, Fort Worth, Tex.

Pawating, Mich. Hospital

Peninsula Air Commission, Va.

Peninsula Industrial Committee, Va.

Peninsula Planning Commission, Va.

Petersburg, Va. Housing and Redevelopment Authority

Philadelphia City Council

Philadelphia General Hospital, Pa.

Phoenix, Ariz.

Phoenix, Ariz. Housing Authority

Pleasant Hill Recreation and Park District

Pleasant Valley, Or. School District

Pompano Park, Fl.

Portage Borough, Pa. Water Authority

Port Everglades, Fl. Authority

Portland, Or.

Portland, Or. School District

Portland, Or. Metropolitan Steering Committee

Portland, Or. Fire and Police Retirement Fund

Portland, Or. Water Bureau

Portland, Or. Development Commission

Portland, Or. Port

Portsmouth, NH

Portsmouth, Mass

Port Washington, Wis. City and School District

Poughkeepsie, NY Housing Authority

Raleigh, NC Housing Authority

Ridgfield, Conn.

Rochester, Mich. Community Schools

Rockford, Ill.

Rockford, Ill. Public Library

Rockford, Ill. School District

Rockville Center, NY Urban Renewal Agency

Sacramento County, Calif.

Saginaw, Detroit, Community Hospital

Salisbury-Rowan, NC Community Service Council

Saluda, NC

San Bernardino, Calif. Electric Co.

Sanford, Fl. Housing Authority

San Mateo, Calif.

Santa Clara County, Calif.

Sapry County, Neb.

Seattle, Wash. City Light

Seattle, Wash. Board of Public Instruction

Self Memorial Hospital, SC

Sellersville Police Pension Fund, Pa.

Selswik, Alas.

South Beloit, Ill. School District

South Broward, Fl. Hospital District

Southeast Michigan Council of Governments

Southeastern Tidewater Opportunity Porgram, Va.

Southeastern Tidewater Area Management, Va.

Southeastern Planning District, Va.

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Southeastern Virginia Area Manpower Authority

South Lane, Or. School District

Spokane, Wash.

Spokane, Wash. Health District

Spokane, Wash.International and Felts Field Airports

St. Louis County, Mo. Special School District

St. Louis County, Mo.

Statesville, NC. OEO Grant

Syracuse, NY School District

Suffolk, Va.

Tempe, Ariz. Union High School District

Tigard, Or.

Tigard, Or. Water District

Tredyffrin Township, Pa. Sewer District

Tri-County Metropolitan Transit District, Portland,Or.

Troy, Mich. School District

Tualatin, Or.

Tualatin Valley Irrigation District, Or.

Tulsa, Okla. General Hospital

Twin County Utility, Fl.

Union High School System, Pheonix, Ariz.

Upper Merion, Pa. School District

Van Buren County, Mich. Road Commission

Vestal, NY School District

Village of Three Oaks, Mich.

Walton Village, NY

Washington County School District, Or.

Watervliet, Mich. Township

Wayne County, Mich. Department of Health

West Deer Township, Pa. School Authority

West Genesee Central School District, NY

West Leechburg, Pa. Water Authority

West Massachusetts, Health Planning Council

Westhill Central School District, NY

Westmoreland County, Pa. Municipal Water Authority

Wheat Ridge, Colo. Water District

Winston-Salem, NC Housing Authority

Woods Hole, Mass.

Wyandotte, Mich.

Wyandotte, Mich. Department of Municipal Services

Wyomissing PolicePension Fund, Pa.

Yakutat, Alas.

Yamhill County, Or.

FEDERAL ENTITIES FOR WHOM SERVICES WERE PERFORMED DURING CALENDAR YEARS 1970 thru 1974

19

Agency for International Development
Federal Reserve Board
U.S. Office of Education
Department of Justice
Department of Helath, Education and Welfare

1971

Securities Investor Protection Corporation
Federal Reserve Board
U.S. Office of Education
Department of Justice
Department of Health, Education and Welfare

1972

Securities Investor Protection Corporation
Federal Reserve Board
Environmental Protection Agency
U.S. Office of Eduction
Department of Health, Education and Welfare
Department of Justice
DOD Computer Institute

1973

Veterans Administration
Federal Reserve System
Environmental Protection Agency
U.S. Office of Education
Bureau of Narcotics and Dangerous Drugs
Law Enforcement Assistance Administration
Army Armaments Command
Department of Health, Education and Welfare
Office of Management and Budget

1974

Cost of Living Council
Federal Energy Office
Interstate Commerce Commission
Bureau of Mines
House of Representatives
Department of Agriculture
Federal Aviation Administration
Army Armaments Command
Drug Enforcement Administration
Law Enforcement Assistance Administration
U.S. Office of Education
Office of Management and Budget
Postal Service

Answer to Question #16

ANNUAL GROSS REVENUES FOR SERVICES
PERFORMED FOR FEDERAL ENTITIES
DURING CALENDAR YEARS 1970 thru 1975

1970	$532,000
1971	$757,000
1972	$589,000
1973	$1,063,000
1974	$789,000
1975	$2,473,000

NOTE: FIGURES ROUNDED TO NEAREST THOUSAND

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

1 March, 1976

Mr. Philip L. Defliese
Managing Partner
Coopers & Lybrand
1251 Avenue of the Americas
New York, New York 10020

Dear Mr. Defliese:

I have your response of 19 February to this subcommittee's accounting questionnaire. Your letter accompanying the response asks confidential treatment for questions six, seven, eleven and sixteen.

Six of the eight firms responding to the questionnaire saw no need to request confidentiality. In view of the open responses by other accounting firms and the need for authoritative information on the accounting profession by Congress and the public, I strongly urge that you reconsider your request for confidential treatment of certain portions of your firm's response.

Although the questionnaire and my letter of transmittal offered no pledge of confidentiality for your response, I will honor your request if you should reaffirm it after reconsideration. However, that grant of confidentiality shall be noted in any publications or proceedings which may be undertaken by this subcommittee regarding accounting matters, and shall not extend to any information which is obviously in the public domain.

I shall appreciate a prompt response regarding reconsideration of the request for confidentiality.

Very truly yours,

Original signed by
Lee Metcalf

COOPERS & LYBRAND
1251 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10020

PHILIP L. DEFLIESE
MANAGING PARTNER

March 26, 1976

Hon. Lee Metcalf, Chairman
Subcommittee on Reports,
Accounting and Management
United States Senate
161 Russell Building
Washington, D. C. 20510

Dear Senator Metcalf:

Thank you for your letter of March 1 with respect to Coopers & Lybrand's response to your Subcommittee's accounting questionnaire.

My Firm does not dispute the need for authoritative information by your Subcommittee and has fully cooperated in providing it. This, however, in no way changes the character of that information as proprietary material relating to a private partnership.

We did not consult with the other firms referred to in your letter and therefore I do not know the reasons why they waived confidential treatment of similar information private to their practice. I sincerely doubt whether these firms would provide Coopers & Lybrand with such information if we were to request it of them.

With respect to the third paragraph of your letter my Firm would have no problem with your noting its request for confidentiality in any publications or proceedings which may be undertaken by your Subcommittee. However, since you seem to believe that lack of confidentiality is necessary to the work of your Subcommittee, my Firm reluctantly acquiesces to your request.

We note that this information is not in the public domain and we would request that your Subcommittee use restraint in the dissemination of it. If there is to be public dissemination, we would appreciate receiving at your earliest convenience copies of the information supplied by the other firms to which you refer who do not see any need for confidentiality.

Very truly yours,

Philip L. Defliese

PLD:dem

ERNST & ERNST
UNION COMMERCE BUILDING
CLEVELAND, OHIO 44115

February 12, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on Reports
and Accounting Mangement
Committee on Government Operations
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

In response to your letter of December 19, 1975, we submit the attached data requested in your questionnaire.

If you need further information to interpret the responses to the questionnaire, or if we can be of any further assistance in meeting the goals of the Subcommittee, please do not hesitate to call.

Sincerely,

R. T. Baker

R. T. Baker
Managing Partner

RTB/nm
enclosure

ERNST & ERNST

Reports, Accounting and Management Subcommittee
Answers to Questionnaire.

1. Please state the number of offices which your firm maintains within the United States.

   112

2. Please indicate the number of states, territories or possessions of the United States in which your firm maintains an office or affiliated office.

   45 states

3. Please state the number of cities outside the United States in which your firm maintains offices or has an affiliation.

   146

4. Please state the number of partners in your firm located in the United States (include only certified public accountants.)

   484 partners

5. Please state the number of principals located in your offices in the United States who are not certified public accountants.

   20 principals

6. Please state the total number of employees of your firm within the United States, excluding only partners and principals.

   5,795 employees

7. Please indicate the approximate percentage of total revenues for services performed by your firm in the following categories.

   It is frequently difficult to classify the types of services provided our clients. This response is based on our internal recording procedures.

   A. Auditing and accounting - 73
   B. Tax services - 17
   C. Management advisory services including executive, recruitment, product analysis, marketing analysis, and plant layout. - 9
   D. Actuarial services - 0
   E. Services performed for Federal, State or local governments - 1
   F. Other - 0

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8. Please state if your firm renders management or other advisory services in the following categories:

   A. Executive recruitment - Yes
   B. Marketing analysis - Yes
   C. Plant layout - Yes
   D. Product analysis - Yes
   E. Actuarial services - No
   F. Federal advisory committees - No.

9. Please state the name and address of corporations listed on the New York Stock Exchange for which your firm is the independent auditor.

   See list attached

10. Please state the name and address of corporations listed on the American Stock Exchange for which your firm is the independent auditor.

   See list attached

11. Please state the number of other publicly-held corporations for which your firm is the independent auditor, and the number of privately held corporations for which your firm is the independent auditor.

   Other publicly-held corporations - approximately 700
   Privately held corporations - approximately 9,000

12. Please indicate the total number of partners, principals and employees of your firm who are members of the American Institute of Certified Public Accountants.

Partners	484
Employees	2,246
Total	2,730

   (As of July 31, 1975, last reporting date.)

13. Please state if your firm has made financial contributions, directly or indirectly, to the Financial Accounting Standards Board. If so, please indicate the amount of contributions made annually to date.

1975	$200,000
1974	200,000
1973	200,000

14. Please identify the department, agencies or subdivisions of any federal, state, municipal or other government authority for which your firm performed any services during 1975.

   See list attached

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15. Please identify the federal departments, agencies, subdivisions or authorities for which your firm has performed services during each year from Jan. 1, 1970 through Dec. 31, 1974.

See list attached

16. Please state your firm's annual gross revenue from services performed for Federal departments, agencies, subdivisions or authorities during each year from Jan. 1, 1970 to Dec. 31, 1975.

1975	$1,025,000
1974	701,000
1973	1,106,000
1972	1,533,000
1971	952,000
1970	584,000

17. Please state if your firm maintains a department, division or office for the procurement of Federal, State and local government contracts. If so, please indicate the name of the person(s) in charge of said department, division or office, and address of such office(s).

Arthur Kober
Director of Federal Programs
1225 Connecticut Ave., N. W.
Washington, D. C. 20036

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Question 9.

New York Stock Exchange Clients

Name	Address
Acme-Cleveland Corp.	Cleveland, Oh
Adams-Millis Corp.	High Point, NC
Alco Standard Corp.	Valley Forge, Pa
Amerace Corp.	New York, NY
American Finance System Inc.	Wilmington, De
American General Bond Fund	Baltimore, Md
American General Convertible Securities	Baltimore, Md
American General Insurance Co.	Houston, Tx
Apeco Corp.	Evanston, Il
Archer-Daniels-Midland Co.	Decatur, Il
Arkansas Best Corp.	Fort Smith, Ar
Armstrong Rubber Co.	New Haven, Ct
Arthur G. McKee & Co.	Independence, Oh
Ashland Oil, Inc.	Russell, Ky
Bandag, Inc.	Muscatine, Ia
Bank of Virginia Co.	Richmond, Va
Basic Inc.	Cleveland, Oh
Becton, Dickinson and Co.	Rutherford, NJ
Beech Aircraft Corp.	Wichita, Ks
Big Three Industries, Inc.	Houston, Tx
Brown Co.	Pasadena, Ca
Brown Group, Inc.	Saint Louis, Mo
Brush Wellman Inc.	Cleveland, Oh
Buffalo Forge Co.	Buffalo, NY
Capital Holding Corp.	Louisville, Ky
Cincinnati Milacron Inc.	Cincinnati, Oh
Clark Oil & Refining Corp.	Milwaukee, Wi
Coca-Cola Bottling Company of N.Y.	Hackensack, NJ
Coldwell, Banker & Co.	Los Angeles, Ca
Continental Illinois Corp.	Chicago, Il
Copeland Corp.	Sidney, Oh
Cowles Communications, Inc.	New York, NY
Crane Co.	New York, NY
Dayco Corp.	Dayton, Oh
Dayton-Hudson Corp.	Minneapolis, Mn
Dennison Manufacturing Co.	Framingham, Ma
E-Systems, Inc.	Dallas, Tx
Eaton Corp.	Cleveland, Oh
Eli Lilly and Co.	Indianapolis, In
Federal-Mogul Corp.	Southfield, Mi
First Virginia Bankshares Corp.	Falls Church, Va
Fisher Foods, Inc.	Bedford Heights, Oh
Florida Steel Corp.	Tampa, Fl
Fuqua Industries, Inc.	Atlanta, Ga
Gable Industries, Inc.	Atlanta, Ga
Gateway Industries, Inc.	Chicago, Il
General American Oil Company of Texas	Dallas, Tx

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Question 9.

Name	Address
General American Transportation	Chicago, Il
General Medical Corp.	Richmond, Va
Genuine Parts Co.	Atlanta, Ga
Gerber Products Co.	Fremont, Mi
GF Business Equipment, Inc.	Youngstown, Oh
Giant Portland Cement Co.	Columbia, SC
Gibraltar Financial Corporation	Beverly Hills, Ca
Gifford-Hill & Company, Inc.	Dallas, Tx
Gleason Works	Rochester, NY
Gould Inc.	Chicago, Il
Gray Drug Stores, Inc.	Cleveland, Oh
Great Northern Iron Ore Properties	Saint Paul, Mn
Gulf & Western Industries, Inc.	New York, NY
Hanes Corp.	Winston-Salem, NC
Harris Corp.	Cleveland, Oh
Harte-Hanks Newspapers, Inc.	San Antonio, Tx
Hoover Ball and Bearing Co.	Saline, Mi
Hospital Corporation of America	Nashville, Tn
J. M. Smucker Co.	Orrville, Oh
John Hancock Income Securities Corp.	Boston, Ma
John Hancock Investors Inc.	Boston, Ma
Jostens, Inc.	Minneapolis, Mn
Keller Industries, Inc.	Miami, Fl
Knight-Ridder Newspapers, Inc.	Miami, Fl
Leesona Corp.	Warwick, RI
Libbey-Owens-Ford Co.	Toledo, Oh
Lincoln National Corp.	Fort Wayne, In
Lincoln National Direct Placement Fund	Chicago, Il
Lomas & Nettleton Financial Corp.	Dallas, Tx
Lomas & Nettleton Mortgage Investors	Dallas, Tx
Malone & Hyde, Inc.	Memphis, Tn
Manpower, Inc.	Milwaukee, Wi
Marathon Oil Co.	Findlay, Oh
Martin Marietta Corp.	Rockville, Md
Maytag Co.	Newton, Ia
McCord Corp.	Detroit, Mi
McDonnell Douglas Corp.	Saint Louis, Mo
McLean Trucking Co.	Winston-Salem, NC
McLouth Steel Corp.	Detroit, Mi
Medusa Corp.	Cleveland Heights, Oh
Midland-Ross Corp.	Cleveland, Oh
Missouri Portland Cement Co.	Saint Louis, Mo
Montgomery Street Income Securities	San Francisco, Ca
Mortgage Trust of America	San Francisco, Ca
Morton-Norwich Products, Inc.	Chicago, Il
Mountain Fuel Supply Co.	Salt Lake City, Ut
Murray Ohio Manufacturing Co.	Brentwood, Tn

Question 9.

Name	Address
Nalco Chemical Co.	Oak Brook, Il
National Gypsum Co.	Buffalo, NY
National Mortgage Fund	Rocky River, Oh
National Steel Corp.	Pittsburgh, Pa
NLT Corp.	Nashville, Tn
North American Coal Corp.	Cleveland, Oh
Northwest Airlines, Inc.	St. Paul, Mn
Peter Paul, Inc.	Naugatuck, Ct
Pittsburgh Forgings Co.	Pittsburgh, Pa
Pizza Hut, Inc.	Wichita, Ks
Ponderosa System, Inc.	Dayton, Oh
R. J. Reynolds Industries, Inc.	Winston-Salem, NC
Redman Industries, Inc.	Dallas, Tx
Reliance Electric Co.	Cleveland, Oh
Republic Steel Corp.	Cleveland, Oh
Reynolds Metals Co.	Richmond, Va
Reynolds Securities, Inc.	New York, NY
Robertshaw Controls Co.	Richmond, Va
Rosario Resources Corp.	New York, NY
Scot Lad Foods, Inc.	Lansing, Il
Scovill Manufacturing Co.	Waterbury, Ct
Shakespeare Co.	Columbia, SC
Sherwin-Williams Co.	Cleveland, Oh
Standard Oil Company of Ohio	Cleveland, Oh
Texas Commerce Bancshares, Inc.	Houston, Tx
Texas Industries, Inc.	Dallas, Tx
The B. F. Goodrich Co.	Akron, Oh
The Black and Decker Manufacturing Co.	Towson, Md
The Cleveland-Cliffs Iron Co.	Cleveland, Oh
The Coca-Cola Co.	Atlanta, Ga
The Hanna Mining Co.	Cleveland, Oh
The Lamson & Sessions Co.	Cleveland, Oh
The LTV Corp.	Dallas, Tx
The Outlet Co.	Providence, RI
The Stanley Works	New Britain, Ct
The Times Mirror Co.	Los Angeles, Ca
The Wachovia Corp.	Winston-Salem, NC
The Warner & Swasey Co.	Cleveland, Oh
The Weatherhead Co.	Cleveland, Oh
Thomas Industries, Inc.	Louisville, Ky
Time Inc.	New York, NY
Timken Co.	Canton, Oh
Tonka Corp.	Hopkins, Mn
Transamerica Corp.	San Francisco, Ca
Tropicana Products, Inc.	Bradenton, Fl
TRW Inc.	Cleveland, Oh

Question 9.

Name	Address
U. S. Industries, Inc.	New York, NY
U. S. Realty Investments	Cleveland, Oh
United Industrial Corp.	New York, NY
United States Tobacco Co.	Greenwich, Ct
V.F. Corp.	Wyomissing, Pa
Wang Laboratories, Inc.	Tewksbury, Ma
Washington National Corp.	Evanston, Il
Weil-McLain Company, Inc.	Dallas, Tx
Western Bancorporation	Los Angeles, Ca
Whirlpool Corp.	Benton Harbor, Mi
White Consolidated Industries	Cleveland, Oh
White Motor Corp.	Cleveland, Oh
Wieboldt Stores, Inc.	Chicago, Il
Wolverine World Wide, Inc.	Rockford, Mi
Zurn Industries, Inc.	Erie, Pa

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Question 10.

American Stock Exchange Clients

Name	Address
A. T. Cross Co.	Lincoln, RI
Acme-Hamilton Manufacturing Co.	Trenton, NJ
Affiliated Hospital Products, Inc.	Saint Louis, Mo.
Altamil Corp.	Fernwood, Ms.
Altec Corp.	Richardson, Tx
American Biltrite Inc.	Cambridge, Ma
American Recreation Group, Inc.	New York, NY
AMIC Corp.	Raleigh, NC
Anken Industries	Morristown, NJ
Anthony Industries, Inc.	South Gate, Ca
Applied Devices Corp.	Hauppauge, NY
Arizona-Colorado Land & Cattle	Phoenix, Az
Ashland Oil Canada Ltd.	Calgary, AB
Aspro, Inc.	Westport, Ct
Barry Wright Corp.	Watertown, Ma
Berven Carpets Corp.	Fresno, Ca
Bodin Apparel, Inc.	Miami, Fl
Brad Ragan, Inc.	Spruce Pine, NC
Brooks & Perkins, Inc.	Southfield, Mi
Bundy Corp.	Detroit Mi
C. H. Masland & Sons	Carlisle, Pa
Cablecom-General, Inc.	Denver, Co
Capitol Food Industries, Inc.	Chicago, Il
Carbon Industries, Inc.	Charleston, WV
Castleton Industries, Inc.	Pompano Beach, Fl
Charter Medical Corp.	Macon, Ga
CHC Corp.	Towson, Md
Child World, Inc.	Avon, Ma
Clarke-Gravely Corp.	Muskegon, Mi
Clausing Corp.	Kalamazoo, Mi
Cohen-Hatfield Industries, Inc.	New York, NY
Conroy, Inc.	San Antonio, Tx
Cook Electric Co.	Morton Grove, Il
Cook Paint and Varnish Co.	North Kansas City, Mo
Crowley, Milner and Co.	Detroit, Mi
Crown Central Petroleum Corp.	Baltimore,Md.
Crystal Oil Co.	Shreveport, La
Cubic Corp.	San Diego, Ca
Diamond M Drilling Co.	Houston, Tx
Dillard Department Stores, Inc.	Little Rock, Ar
Diodes Inc.	Woodland Hills, Ca
Driver-Harris Co.	Harrison, NJ
E. T. Barwick Industries, Inc.	Chamblee, Ga
Electronic Research Associates, Inc.	Moonachie, NJ

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Question 10.

Name	Address
F. W. Means & Co.	Chicago, Il
Federal Resources Corp.	Salt Lake City, Ut
First of Denver Mortgage Investors	Denver, Co
First S&L Shares, Inc.	Denver, Co
Flagg Industries, Inc.	Los Angeles, Ca
FDX-Stanley Photo Products, Inc.	San Antonio, Tx
Friedman Industries, Inc.	Houston, Tx
Frontier Airlines, Inc.	Denver, Co
Garcia Corp.	Teaneck, NJ
General Employment Enterprises	Chicago, Il
Geo. A. Hormel & Co.	Austin, Mn
Glen-Gery Corp.	Reading, Pa
Gorman-Rupp Co.	Mansfield, Oh
Great Lakes Chemical Corp.	West Lafayette, In
Gross Telecasting, Inc.	Lansing, Mi
Grow Chemical Corp.	New York, NY
Guardsman Chemical Inc.	Grand Rapids, Mi
Harman International Industries, Inc.	Lake Success, NY
Hospitality Motor Inns, Inc.	Cleveland, Oh
Huck Manufacturing Co.	Detroit, Mi
Imperial Industries, Inc.	Miami, Fl
Inarco Corp.	Twinsburg, Oh
International Banknote Company	New York, NY
International Couriers Corp.	Chicago, Il
International Proteins Corp.	Fairfield, NJ
International Stretch Products, Inc.	New York, NY
Killearn Properties, Inc.	Tallahassee, Fl
Kin-Ark Corp.	Tulsa, Ok
Laneco, Inc.	Easton, Pa
Lea-Ronal, Inc.	Freeport, NY
Leigh Products, Inc.	Grand Rapids, Mi
Louisville Cement Co.	Louisville, Ky
Mammoth Mart, Inc.	West Bridgewater, Ma
McDonough Co.	Parkersburg, WV
New Process Co.	Warren, Pa
Nuclear Data, Inc.	Schaumburg, Il
Ohio Brass Co.	Mansfield, Oh
Onan Corp.	Minneapolis, Mn
Oriole Homes Corp.	Margate, Fl
Overhead Door Corp.	Dallas, Tx
Paramount Packaging Corp.	Chalfont, Pa
Patagonia Corp.	Tucson, Az
Pittsburgh-Des Moines Steel Co.	Pittsburgh, Pa
Pneumo Corp.	Boston, Ma
R. H. Medical Services, Inc.	Elkins Park, Pa
Ransburg Corp.	Indianapolis, In
Risdon Manufacturing Co.	Naugatuck, Ct
Roblin Industries, Inc.	Buffalo, NY
RPS Products, Inc.	Baltimore, Md

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Question 10.

Name	Address
Russell Corp.	Alexander City, Al
Schiller Industries, Inc.	Warren, Mi
Shelter Resources Corp.	Lyndhurst, Oh
Sigma Instruments, Inc.	South Braintree, Ma
Sikes Corp.	Lakeland, Fl
Southeastern Capital Corp.	Atlanta, Ga
Spartek Inc.	Canton, Oh
Standard Alliance Industries	Oak Brook, Il
STP Corp.	Fort Lauderdale, Fl
Sunshine-Jr. Stores, Inc.	Panama City, Fl
Tejon Ranch Co.	Los Angeles, Ca
Tenna Corp.	Cleveland, Oh
The Coleman Company, Inc.	Wichita, Ks
The Eastern Co.	Naugatuck, Ct
The Harvey Group Inc.	Woodbury, NY
The Ohio Art Co.	Bryan, Oh
The Valspar Corp.	Minneapolis, Mn
Thriftimart, Inc.	Los Angeles, Ca
Tidwell Industries, Inc.	Haleyville, Al
Tracor, Inc.	Austin, Tx
Tuftco Corp.	Chattanooga, Tn
U.S. Reduction Co.	East Chicago, In
Universal Cigar Corp.	New York, NY
U & I, Inc.	Salt Lake City, Ut
Valley Metallurgical Processing Co., Inc.	New York, NY
Valmac Industries, Inc.	Memphis, Tn
Vermont American Corp.	Louisville, Ky
Vertipile, Inc.	Leominster, Ma
Vishay Intertechnology, Inc.	Malvern, Pa
Walco National Corp.	New York, NY
Weiman Company, Inc.	Chicago, Il
Whitehall Corp.	Dallas, Tx

14. Services performed for:

Federal:
- Department of Agriculture
- Department of Commerce
- Department of Health, Education & Welfare
- Department of Transportation
- Environmental Protection Agency
- National Science Foundation
- U. S. Postal Service

State, Municipal or Other Government Authority:

- Allegheny County Office of Economic Opportunity, Pittsburgh
- Arizona Outdoor Recreation Coordinator
- Community Services Association, Jackson, Miss.
- Dekalb Water & Sewer Department, Atlanta
- D. C. Public Service Commission
- Hawaii (State of)-Campaign Spending
- Industrial Development Board - Memphis
- Mahoning-Trumbull Council of Government
- Metropolitan Emergency Medical Service - Atlanta
- Model Cities-Board of Education-St. Louis
- Mississippi Regional Housing Authority-jackson, Miss.
- Multnoman County Public Works Department, Portland, Ore.
- Muskegon County Wastewater Management
- New England Regional Commission, Boston
- New York City Fire Department
- Regional Transportation Authority - Chicago
- Royal Palm Improvement Association - Ft. Lauderdale
- Toledo Metropolitan Park District
- Town of Hastings, Florida
- Washington, D. C. Metro Area Transportation
- Piedmont Triad Council of Government
- Cleveland, City of, Office of the Mayor
- Cleveland City Council
- Cuyahoga County Data Processing Board
- City of Akron Water Pollution Control
- Medina, Ohio, City of
- Medina, Ohio, County Board of Commissioners
- Sodus, New York, Village of
- Syracuse, City of
- Onondaga County, N. Y., Personnel Department
- City of Toledo, Model Cities
- Fulton County, Georgia, County Government
- St. Cloud, Florida, City of
- Daytona Beach, City of
- Salley, South Carolina, Town of
- Genesee, Michigan, County of

14. State, Municipal or Other Government Authority: (continued)

Wayne County, Michigan, Board of Auditors
Wayne County, Michigan, Circuit Court
Washtenaw County, Michigan, Drain Commission
Parchment, Michigan, City of
Lake Forest, Illinois, City of
Marquette, City of
Republic Township, Michigan
Boise, City of
Boise, City of, Mud Project
Oakland County, California
San Jose, California, City of
New Jersey Department of Civil Service
New Jersey Department of Institutions
Governor's Council for Cost Control (Ohio)
Ohio Department of Health
Ohio Department of Mental Health or Retardation
Cincinnati (City of)
West Virginia Housing Development
Alabama (State of) Budgets
Michigan Supreme Court
Wayne County (Michigan) Juvenile Court
Michigan Department of Commerce
Michigan Department of Agriculture
Wyoming, State of
Wisconsin Council on Criminal Justice
Arkansas, State of
Seattle, City of-Office of Community Development
Washington, State of
Washington, State Legislature
New York City, Department of Consumer Affairs
Revere, Massachusetts, City of
North Kingston, Rhode Island, Town of
Norwich, Connecticut, City of
Cumberland, Maryland, City of
Harrisburg, Pennsylvania, Redevelopment Authority
Washington, D. C. Public Service Commission

15. Services performed for federal departments, agencies, subdivisions, or authorities:

1970

Agency for International Development
Department of Agriculture
Department of Commerce
Department of Housing and Urban Development
Department of Labor
Department of Health, Education & Welfare
Department of Transportation
Economic Development Administration
Food and Drug Administration
National Academy of Science
United States Post Office Department

1971

Agency for International Development
Department of Health, Education and Welfare
Department of Housing and Urban Development
Department of Transportation
Economic Development Administration
Food and Drug Administration
General Services Administration
United States Postal Service

1972

Atomic Energy Commission
Department of Agriculture
Department of Army - Corps of Engineers
Department of Commerce
Department of Health, Education & Welfare
Environmental Protection Agency
Federal Railway Administration
United States Postal Service
Treasury Department

1973

Cost of Living Council
Department of Commerce
Department of Army - Corp of Engineers
Department of Transportation
Environmental Protection Agency
Department of Health, Education & Welfare
United States Postal Service

15. Services performed for federal departments, agencies, subdivisions, or authorities: (continued)

1974

Department Agriculture
Department of Commerce
Department of Maritime Administration
Department of Health, Education & Welfare
United States Postal Service

HASKINS & SELLS

CERTIFIED PUBLIC ACCOUNTANTS

MICHAEL N. CHETKOVICH
MANAGING PARTNER

EXECUTIVE OFFICE
1114 AVENUE OF THE AMERICAS
NEW YORK, NEW YORK 10036

February 17, 1976

The Honorable Lee Metcalf
United States Senate
Subcommittee on Reports,
Accounting and Management
Washington, D.C. 20510

Dear Mr. Metcalf:

The information contained in the following sections of this document has been prepared in response to the questionnaire enclosed with your letter of December 19, 1975. The nature of the data used in response to each question is described along with the answer to that question. Numerical data presented in this document are based on available internal records which are generally related to our fiscal year of fifty-two weeks ending on approximately May 31.

We hope that this background information will be helpful to the Subcommittee. We shall be pleased to provide any further assistance that may be required to enable the Subcommittee to fully consider the specific matters noted in your letter of December 19.

Very truly yours,

Michael N. Chetkovich

Michael N. Chetkovich

Enclosures

RESPONSE TO DECEMBER 19, 1975 QUESTIONNAIRE
OF
UNITED STATES SENATE
COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT

QUESTION 1. Please state the number of offices which your firm maintains within the United States. (If more than one partnership, corporation or other entity exists in the United States, please furnish all names and answer subsequent questions accordingly).

RESPONSE During the last fiscal year which ended May 31, 1975 the Firms of Haskins & Sells had 93 offices within the United States. A listing of the Firm's offices which may be helpful to the Subcommittee is contained in Exhibit A, the most recent Directory published for use of our clients and personnel. All of our practice in the United States is conducted under the partnership name of Haskins & Sells. The responses to the questionnaire that follow have been prepared for that practice.

QUESTION 2. Please indicate the number of states, territories, or possessions of the United States in which your firm maintains an office or affiliated office.

RESPONSE During the fiscal year ending May 31, 1975, Haskins & Sells maintained offices in forty states, territories, or possessions of the United States. The Directory (Exhibit A) gives further detail as to the location of our offices.

QUESTION 3. Please state the number of cities outside the United States in which your firm maintains offices or has an affiliate office.

RESPONSE During the last fiscal year which ended May 31, 1975, Haskins & Sells had an affiliation with firms that maintained offices in 137 cities outside the United States. These cities are shown in the Directory (Exhibit A) under the title of Deloitte, Haskins & Sells (pages 19-44). In addition, Haskins & Sells maintains relationships with a number of correspondent firms in cities outside of the United States. The locations of these correspondent firms are shown in the Directory (pages 45-54).

QUESTION 4. Please state the number of partners in your firm located in the United States (include only certified public accountants).

RESPONSE At June 1, 1975 there were 443 active partners of Haskins & Sells located in the United States. All partners of Haskins & Sells are certified public accountants.

QUESTION 5. Please state the number of principals located in your offices in the United States who are not certified public accountants.

RESPONSE Haskins & Sells has no "principals" in the firm who are not certified public accountants. We have assumed that the word "principal" is being used to describe an individual who has an equity in the firm and shares in the profits of the firm. In Haskins & Sells only partners, all of whom are certified public accountants, have such an equity position. At June 1, 1975 we did have, however, 12 individuals with the title "director", who function at the administrative level of a partner in the conduct of our Management Advisory Services practice. While directors share in the profits of the firm they do not have an equity in the firm.

QUESTION 6. Please state the total number of employees of your firm within the United States, excluding only partners and principals.

RESPONSE At May 31, 1975, Haskins & Sells had 4,798 employees located in the United States.

QUESTION 7. Please indicate the approximate percentage of total revenue for services performed by your firm in the following categories:

A. Auditing and accounting

B. Tax services

C. Management advisory services, including executive recruitment, product analysis, market analysis, and plant layout

D. Actuarial services

E. Services performed for Federal, State or local government

F. Other

RESPONSE For the year ended May 31, 1975, we have estimated from our statistical records that the revenues of Haskins & Sells were divided among the specified service categories as follows:

A.	Auditing and accounting	74%
B.	Tax services	15
C.	Management advisory services	5
D.	Actuarial services	(See comment)
E.	Services performed for Federal, State or local government	(See comment)
F.	Other	6
	Total	100%

Actuarial Services Haskins & Sells does not provide what we consider to be "actuarial services". We do utilize actuarial skills as required in our auditing and accounting services and accordingly any use of these skills is classified in our statistical records as auditing and accounting services. We estimate, however, that the revenue that might be related to use of these skills is a small fraction of 1% of our total revenue.

Services for Government Entities We perform auditing and accounting and management advisory services for governmental entities. Data regarding our services is normally classified in our statistical records by the nature of the services performed and not by the type of entity served. We estimate, however, that revenues from our services for Federal, State and local governments amount to less than 5% of our total revenues.

QUESTION 8. Please state if your firm renders management or other advisory services in the following categories:

A. Executive recruitment

B. Marketing analysis

C. Plant Layout

D. Product analysis

E. Actuarial services

F. Federal advisory committees

RESPONSE We do provide assistance to clients in identification and screening of candidates for executive and middle management positions. In this narrow sense, we provide services in the area of executive recruitment. We do not provide services that we would classify under the other categories specified.

QUESTION 9. Please state the names and addresses of corporations listed on the New York Stock Exchange for which your firm is the independent auditor.

RESPONSE The names and addresses of corporations listed on the New York Stock Exchange for which Haskins & Sells was the independent auditor at May 31, 1975 are listed in Exhibit B.

QUESTION 10. Please state the names and addresses of corporations listed on the American Stock Exchange for which your firm is the independent auditor.

RESPONSE The names and addresses of corporations listed on the American Stock Exchange for which Haskins & Sells was the independent auditor at May 31, 1975 are listed in Exhibit C.

QUESTION 11. Please state the number of other publicly-held corporations for which your firm is the independent auditor, and the number of privately-held corporations for which your firm is the independent auditor.

RESPONSE We have defined "other publicly-held corporations" to be those corporations which are required to file information with the Securities and Exchange Commission and are not listed on the New York or American Stock Exchanges. Haskins & Sells was the independent auditor for 369 such publicly-held companies at May 31, 1975.

We have defined "privately-held corporations" as all of our audit clients that do not file information with the Securities and Exchange Commission. At May 31, 1975 Haskins & Sells was the independent auditor for 4,798 such corporations.

QUESTION 12. Please indicate the total number of partners, principals and employees of your firm who are members of the American Institute of Certified Public Accountants.

RESPONSE Our personnel records indicate that 1,235 partners and employees of Haskins & Sells were members of the American Institute of Certified Public Accountants at May 31, 1975. All partners are both CPAs and members of the AICPA.

QUESTION 13. Please state if your firm has made financial contributions, directly or indirectly, to the Financial Accounting Standards Board. If so, please indicate the amount of contributions made annually to date.

RESPONSE Haskins & Sells has paid the following annual dues to the Accounting Research Association of the American Institute of Certified Public Accountants:

1973	$200,000
1974	200,000
1975	200,000

The Accounting Research Association contributes to the support of the Financial Accounting Standards Board.

QUESTION 14. Please identify the departments, agencies, or subdivisions of any Federal, State, municipal or other government authority for which your firm performed any services during 1975.

RESPONSE Departments, agencies, and sub-divisions or authorities of Federal, State, and municipal or other government authorities for which Haskins & Sells performed a significant amount of services during the fiscal year ended May 31, 1975 are listed in Exhibit D.

QUESTION 15. Please identify the Federal departments, agencies, sub-divisions or authorities for which your firm has performed services during each year from January 1, 1970 through December 31, 1974.

RESPONSE Departments, agencies, and sub-divisions or authorities of the Federal government for which Haskins & Sells has performed a significant amount of services for the five fiscal years ending May 30, 1970 through June 1, 1974 are listed in Exhibit E.

QUESTION 16. Please state your firm's annual gross revenue from services performed for Federal departments, agencies, sub-divisions or authorities during each year from January 1, 1970 to December 31, 1975.

RESPONSE We estimate that the annual gross revenue from services performed for Federal departments, agencies, sub-divisions or authorities for the six years 1970-1975 was as follows:

Fiscal Year Ended	Gross Revenue
May 30, 1970	$ 185,000
May 29, 1971	540,000
June 3, 1972	1,120,000
June 3, 1973	1,165,000
June 1, 1974	920,000
May 31, 1975	1,160,000

QUESTION 17. Please state if your firm maintains a department, division, or office for the procurement of Federal, State and local government contracts. If so, please indicate the name of the person(s) in charge of said department, division or office, and the address of such office(s).

RESPONSE Haskins & Sells does not maintain a department, division, or office for the procurement of Federal, State and local government contracts. Relationships with government entities are handled by the practice office responsible for performance of the services required. This means that relationships with Federal entities are largely the responsibility of individuals in our Washington, D.C. office who have experience in Federal activities and tend to specialize in this aspect of our practice.

EXHIBITS

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RESPONSE TO DECEMBER 19, 1975 QUESTIONNAIRE

OF

UNITED STATES SENATE

COMMITTEE ON

GOVERNMENT OPERATIONS

SUB-COMMITTEE ON REPORTS

ACCOUNTING, AND MANAGEMENT

(Staff note: Exhibit A, Haskins & Sells 1974-75 "Directory for our Clients and for our Personnel ," retained in committee files.)

HASKINS & SELLS

FEBRUARY, 1976

EXHIBIT B

CLIENTS OF HASKINS & SELLS

CORPORATIONS LISTED ON THE NEW YORK STOCK EXCHANGE

NAME	ADDRESS	
A.E. Staley Manufacturing Company	Decatur	Ill.
A.J. Industries, Inc.	Los Angeles	Calif.
Airco, Inc.	Montvale	N.J.
Allied Supermarkets, Inc.	Livonia	Mich.
Alpha Portland Industries, Inc.	Easton	Pa.
Ambac Industries, Inc.	Carle Place	N.Y.
American Electric Power Company	New York	N.Y.
American Investment Company	Saint Louis	Mo.
Amfac, Inc.	Honolulu	Hawaii
Aristar, Inc.	Wilmington	Del.
Arizona Public Service Company	Phoenix	Ariz.
Armco Steel Corp.	Middletown	Ohio
Atlantic City Electric Company	Atlantic City	N.J.
Baker Oil Tools, Inc.	Commerce	Calif.
Bank of New York Company, Inc.	New York	N.Y.
Bearings, Inc.	Cleveland	Ohio
The Bendix Corp.	Southfield	Mich.
Beneficial Corp.	Wilmington	Del.
Blue Bell, Inc.	Greensboro	N.C.
Braniff International Corp.	Dallas	Texas
Bunker Ramo Corp.	Oak Brook	Ill.
Burlington Northern, Inc.	Saint Paul	Minn.
Carolina Power & Light Company	Raleigh	N.C.
Castle & Cooke, Inc.	Honolulu	Hawaii
Chris-Craft Industries, Inc.	New York	N.Y.
Citizens and Southern Realty Investors	Atlanta	Ga.
The Clorox Company	Oakland	Calif.
Cluett Peabody & Company, Inc.	New York	N.Y.
Commonwealth Oil Refining Company	New York	N.Y.
Communications Satellite Corp.	Washington	D.C.
Continental Can Company, Inc.	New York	N.Y.
Copperweld Corp.	Pittsburgh	Pa.
Cox Broadcasting Corp.	Atlanta	Ga.
Dean Witter Organization, Inc.	San Francisco	Calif.
Deere & Company	Moline	Ill.
The Deltona Corp.	Miami	Fla.
Diamond International Corp.	New York	N.Y.
The Dow Chemical Company	Midland	Mich..
Duke Power Company	Charlotte	N.C.
Duquesne Light Company	Pittsburgh	Pa.

EXHIBIT B

CLIENTS OF HASKINS & SELLS

CORPORATIONS LISTED ON THE NEW YORK STOCK EXCHANGE

NAME	ADDRESS	
Eckherd Drugs, Inc.	Charlotte	N.C.
Emhart Corp.	Farmington	Conn.
Envirotech Corp.	Menlo Park	Calif.
Equitable Life Mortgage and Realty Investors	Boston	Mass.
Falstaff Brewing Corp.	St. Louis	Mo.
Federal Paper Board Company, Inc.	Montvale	N.J.
Filtrol Corp.	Los Angeles	Calif.
Fischbach and Moore, Inc.	New York	N.Y.
Florida Power & Light Company	Miami	Fla.
Foremost-McKesson, Inc.	San Francisco	Calif.
GAF Corp.	New York	N.Y.
Garlock, Inc.	Rochester	N.Y.
General Motors Corp.	Detroit	Mich.
The Great Atlantic & Pacific Tea Company	New York	N.Y.
Gulf Life Holding Company	Jacksonville	Fla.
H.H. Robertson Company	Pittsburgh	Pa.
Hatteras Income Securities, Inc.	Charlotte	N.C.
Hobart Corp.	Troy	Ohio
Holly Sugar Corp.	Colorado Spgs.	Colo.
Homestake Mining Company	San Francisco	Calif.
Honeywell, Inc.	Minneapolis	Minn.
Host International, Inc.	Santa Monica	Calif.
Houdaille Industries, Inc.	Buffalo	N.Y.
House of Fabrics, Inc.	Sun Valley	Calif.
Household Finance Corp.	Chicago	Ill.
Houston Lighting & Power Company	Houston	Texas
Houston Natural Gas Corp.	Houston	Texas
Hughes Tool Company	Houston	Texas
Idaho Power Company	Boise	Idaho
Ideal Basic Industries, Inc.	Denver	Colo.
Indianapolis Power & Light Company	Indianapolis	Ind.
Integon Corp.	Winston-Salem	N.C.
International Harvester Company	Chicago	Ill.
Interstate Power Company	Dubuque	Iowa
J.P. Morgan & Company, Inc.	New York	N.Y.
J.W. Mays, Inc.	Brooklyn	N.Y.
Jantzen, Inc.	Portland	Oregon
Kaiser Aluminum & Chemical Corp.	Oakland	Calif.
Kaufman and Broad, Inc.	Los Angeles	Calif.
Kawecki Berylco Industries, Inc.	Reading	Pa.
Kimberly-Clark Corp.	Neenah	Wisc.
Laclede Gas Company	Saint Louis	Mo.
Leaseway Transportation Corp.	Cleveland	Ohio

EXHIBIT B

CLIENTS OF HASKINS & SELLS

CORPORATIONS LISTED ON THE NEW YORK STOCK EXCHANGE

NAME	ADDRESS	
Liggett & Myers, Inc.	Durham	N.C.
Lone Star Gas Company	Dallas	Texas
Longs Drug Stores, Inc.	Walnut Creek	Calif.
Lubrizol Corp.	Wickliffe	Ohio
M. Lowenstein & Sons, Inc.	New York	N.Y.
Macmillan, Inc.	New York	N.Y.
Magic Chef, Inc.	Cleveland	Tenn.
Manufacturers Hanover Corp.	Dover	Del.
Mapco, Inc.	Tulsa	Okla.
McCrory Corp.	New York	N.Y.
Merrill Lynch & Company, Inc.	New York	N.Y.
Middle South Utilities, Inc.	New Orleans	La.
Minnesota Mining and Manufacturing Company	Saint Paul	Minn.
Monogram Industries, Inc.	Santa Monica	Calif.
Monsanto Company	Saint Louis	Mo.
National Airlines, Inc.	Miami	Fla.
Norlin Corp.	New York	N.Y.
Norris Industries, Inc.	Los Angeles	Calif.
Northern States Power Company	Minneapolis	Minn.
Norton Simon, Inc.	New York	N.Y.
Ogden Corp.	New York	N.Y.
Omark Industries, Inc.	Portland	Oregon
Oneida Ltd.	Oneida	N.Y.
Pacific Gas and Electric Company	San Francisco	Calif.
Pacific Lighting Corp.	Los Angeles	Calif.
Pacific Power & Light Company	Portland	Oregon
Palm Beach Company	Cincinnati	Ohio
Penn Central Company	Philadelphia	Pa.
Pennsylvania Power & Light Company	Allentown	Pa.
Philips Industries, Inc.	Dayton	Ohio
Piedmont Natural Gas Company	Charlotte	N.C.
PPG Industries, Inc.	Pittsburgh	Pa.
Procter & Gamble Company	Cincinnati	Ohio
Public Service Electric and Gas Company	Newark	N.J.
Puerto Rican Cement Company, Inc.	San Juan	Puerto Rico
Rapid-American Corp.	New York	N.Y.
Rexham Corp.	New York	N.Y.
Rio Grande Industries, Inc.	Denver	Colo.
Rockwell International Corp.	El Segundo	Calif.
Sabine Royalty Corp.	Dallas	Texas
San Diego Gas & Electric Company	San Diego	Calif.
Schering-Plough Corp.	Kenilworth	N.J.
SCM Corp.	New York	N.Y.
Seaboard Coast Line Industries	Richmond	Va.

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EXHIBIT B

CLIENTS OF HASKINS & SELLS

CORPORATIONS LISTED ON THE NEW YORK STOCK EXCHANGE

NAME	ADDRESS	
Sedco, Inc.	Dallas	Texas
The Signal Companies, Inc.	Beverly Hills	Calif.
Soo Line Railroad Company	Minneapolis	Minn.
South Carolina Electric & Gas Company	Columbia	S.C.
South Jersey Industries, Inc.	Folsom	N.J.
Southeast Banking Corp.	Miami	Fla.
Southern Pacific Company	San Francisco	Calif.
Springs Mills, Inc.	Fort Mill	S.C.
St. Joe Minerals Corp.	New York	N.Y.
St. Regis Paper Company	New York	N.Y.
Standex International Corp.	Andover	Mass.
Stauffer Chemical Company	Westport	Conn.
Tektronix, Inc.	Beaverton	Oregon
Texfi Industries, Inc.	Greensboro	N.C.
Trans World Airlines, Inc.	New York	N.Y.
Transcon Lines	El Segundo	Calif.
Tri-Continental	New York	N.Y.
Tucson Gas & Electric Aompany	Tucson	Ariz.
Union Camp Corp.	Wayne	N.J.
Union Pacific Corp.	New York	N.Y.
Uniroyal, Inc.	New York	N.Y.
United States Leasing International, Inc.	San Francisco	Calif.
Utah Power & Light Company	Salt Lake City	Utah
Vetco Offshore Industries, Inc.	Ventura	Calif.
Vulcan Materials Company	Birmingham	Ala.
Washington Water Power Company	Spokane	Wash.
Watkins-Johnson Company	Palo Alto	Calif.
Wells Rich Greene, Inc.	New York	N.Y.
Wometco Enterprises, Inc.	Miami	Fla.
The Wurlitzer Company	Chicago	Ill.

EXHIBIT C

CLIENTS OF HASKINS & SELLS

CORPORATIONS LISTED ON THE AMERICAN STOCK EXCHANGE

NAME	ADDRESS	
Aiken Industries, Inc.	New York	N.Y.
Ajax Magnethermic Corp.	Warren	Ohio
American Business Products, Inc.	Atlanta	Ga.
American Manufacturing Company	Brooklyn	N.Y.
American Technical Industries	Mount Vernon	N.Y.
Ampex Corp.	Redwood	Calif.
Armac Enterprises	Chicago	Ill.
Associated Mortgage Investors	Coral Gables	Fla.
Astrodata, Inc.	Anaheim	Calif.
Atco Industries, Inc.	Stratford	Conn.
Augat, Inc.	Attleboro	Mass.
Automated Building Components	Miami	Fla.
Automatic Radio Mfg. Company	Melrose	Mass.
Automatic Switch Company	Florham Park	N.J.
Aydin Corp.	Fort Washington	Pa.
Behavioral Research Laboratories, Inc.	Menlo Park	Calif.
Benrus Corp.	Ridgefield	Conn.
Bergen Brunswig Corp.	Los Angeles	Calif.
Bic Pen Corp.	Milford	Conn.
Bradford Computer & Systems, Inc.	New York	N.Y.
Braniff Airways, Inc.	Dallas	Texas
Breeze Corporations, Inc.	Union	N.J.
California Life Corp.	Los Angeles	Calif.
California Portland Cement Company	Los Angeles	Calif.
Cellu-Craft, Inc.	New Hyde Park	N.Y.
Clarkson Industries, Inc.	New York	N.Y.
Computer Instruments Corp.	Hempstead	N.Y.
Cordon International Corp.	Los Angeles	Calif.
Cox Cable Communications, Inc.	Atlanta	Ga.
Delta Corporation of America	Miami	Fla.
Deseret Pharmaceutical Company	Sandy	Utah
Dial Financial Corp.	Des Moines	Iowa
Digicon, Inc.	Houston	Texas
Elco Industries	Rockford	Ill.
Electrographic Corp.	Chicago	Ill.
Empress International Ltd.	Lake Success	N.Y.
Galaxy Carpet Mills, Inc.	Elk Grove Villa	Ill.
The Golden Cycle Corp.	Colorado Spgs.	Colo.

EXHIBIT C

CLIENTS OF HASKINS & SELLS

CORPORATIONS LISTED ON THE AMERICAN STOCK EXCHANGE

NAME	ADDRESS	
Hawaiian Airlines, Inc.	Honolulu	Hawaii
Horn & Hardart Company	New York	N.Y.
Hospital Mortgage Group	North Miami	Fla.
Hudson General Corp.	Great Neck	N.Y.
IPCO Hospital Supply Corp.	Valhalla	N.Y.
John H. Harland Company	Atlanta	Ga.
Kansas Gas & Electric Company	Wichita	Kans.
Lee Pharmaceuticals	South El Monte	Calif.
Loew's Theatres, Inc.	New York	N.Y.
Maine Public Service Company	Presque Isle	Maine
Maul Bros., Inc.	Millville	N.J.
The Midland Company	Cincinnati	Ohio
Mount Vernon Mills, Inc.	Greenville	S.C.
MPS International Corp.	New York	N.Y.
National Power & Light	Raleigh	N.C.
The New York Times Company	New York	N.Y.
Overseas Securities Company, Inc.	New York	N.Y.
P.H. Glatfelter Company	Spring Grove	Pa.
Penn Engineering & Manufacturing Corp.	Doylestown	Pa.
Permaneer Corp.	Maryland Height	Mo.
Pratt & Lambert, Inc.	Buffalo	N.Y.
Prentice-Hall, Inc.	Englewood Cliff	N.J.
Presidential Realty Corp.	White Plains	N.Y.
Rossmoor Corp.	Laguna Hills	Calif.
Rowan Companies, Inc.	Houston	Texas
Ruddick Corp.	Charlotte	N.C.
Sabine Royalty Corp.	Dallas	Texas
Saturn Airways, Inc.	Oakland	Calif.
Schenuit Industries, Inc.	Baltimore	Md.
Sears Industries, Inc.	New York	N.Y.
Shaer Shoe Corp.	Manchester	N.H.
Sorg Paper Company	Middletown	Ohio
Southland Royalty Company	Fort Worth	Texas
Spencer Foods, Inc.	Spencer	Iowa
Standard-Coosa-Thatcher Company	Chattanooga	Tenn.
Standard Shares, Inc.	New York	N.Y.
Starrett Housing Corp.	New York	N.Y.
Syntex Corp.	Panama City	Panama
Texas Power & Light Company	Dallas	Texas
United Companies Financial Corp.	Baton Rouge	La.

EXHIBIT C

CLIENTS OF HASKINS & SELLS

CORPORATIONS LISTED ON THE AMERICAN STOCK EXCHANGE

NAME	ADDRESS	
Wadell Equipment Company, Inc.	Edison	N.J.
Welldo Enterprises, Inc.	Waynesville	N.C.
Western Financial Corp.	Phoenix	Ariz.
Wichita Industries, Inc.	New York	N.Y.
Willcox & Gibbs, Inc.	New York	N.Y.
Wrather Corp.	Beverly Hills	Calif.
WUI, Inc.	New York	N.Y.
Yates Industries, Inc.	Burdentown	N.J.
Zero Manufacturing Company	Burbank	Calif.
Zimmer Homes Corp.	Pompano Beach	Fla.

EXHIBIT D

CLIENTS OF HASKINS & SELLS

FEDERAL, STATE, MUNICIPAL DEPARTMENTS, AGENCIES OR SUB-DIVISIONS FOR WHICH A SIGNIFICANT AMOUNT OF SERVICES WERE PERFORMED DURING FISCAL YEAR ENDED MAY 31, 1975

FEDERAL

- Federal Energy Administration
- Federal Savings and Loan Insurance Corporation
- General Services Administration
- United States Department of the Navy
- Comptroller of the Currency

STATE

- Arizona State Retirement Systems
- Colorado Department of Natural Resources
- Colorado Department of Social Services - Division of Public Welfare
- Connecticut Development Authority
- Connecticut Resources Recovery Authority
- Connecticut, State of - State Welfare Department
- Department of Business Regulations - Florida
- State of Illinois - Department of Financial Institutions
- State of Illinois - Office of General Auditors
- Department of Audits - State of Illinois
- Department of Social & Healing Services - State of Washington
- Dormitory Authority of the State of New York
- State of Hawaii - Hawaii Housing Authority
- Maryland Health Service Cost Review Commission
- Maryland Port Administration
- Michigan Bureau of State Lottery
- New Jersey State Lottery Commission
- Office of Accounting Services - Washington
- Ohio Department of Public Welfare
- Ohio Department of Administrative Services
- City of St. Clair Shores - Michigan
- San Juan Superior Court - Calderon Case - Puerto Rico
- State of Rhode Island Lottery Study Committee
- Transportation Research Center of Ohio
- Trinity River Authority of Texas
- State of Utah Division of Corrections

MUNICIPAL

- Borough of Ambler Municipality - Pennsylvania
- Borough of Audubon Municipality - New Jersey
- Borough of Berlin Municipality - New Jersey
- City of Cape May - New Jersey
- City of Chandler - Arizona

EXHIBIT D

CLIENTS OF HASKINS & SELLS

FEDERAL, STATE, MUNICIPAL DEPARTMENTS, AGENCIES OR SUB-DIVISIONS
FOR WHICH A SIGNIFICANT AMOUNT OF SERVICES WERE PERFORMED
DURING FISCAL YEAR ENDED MAY 31, 1975

MUNICIPAL (Continued)

City of Charlotte - Mecklenburg Board of Education - North Carolina
Chatham County - Georgia
City of Cincinnati (Municipality) - Ohio
Township of Cinnaminson - Municipality - New Jersey
City of Bountiful Employees Retirement Fund - Utah
City of Alexandria Louisiana
City of Globe - Arizona
City of Dallas - Texas
City of Dallas, Texas, HUD Grant Fund
Township of Delran Municipality - New Jersey
Deptford Township Municipality - New Jersey
Douglas County Health Department - Nebraska
Douglas County - Nebraska
Town of East Hartford - Bd. of Education - Connecticut
Town of Fairfield - Connecticut
Fairfield Township Municipality - New Jersey
Township of Florence Municipality - New Jersey
Fort Bend County - Texas
Grand Jury of Alameda of California
Township of Greenwich (Gloucester County) - New Jersey
Gwinnett County Water & Sewage Authority - Georgia
Haddon Heights Borough Municipality - New Jersey
County of Hawaii
City of Hollywood - Florida
Housing Authority of the City of Indianapolis - Indiana
Howard County - Maryland
Independent School District No. 196 - Minnesota
Board of Commissioners of Kankakee County-Illinois
Borough of Lansdale - Pennsylvania
City of Leesburg, Florida
Borough of Medford Lakes Municipality - New Jersey
Township of Medford Municipality - New Jersey
City of Mesquite - Texas
Metropolitan Dade County - Florida
Department of Water Sewage - Tennessee
Metropolitan Government Nashville & Davidson County - Tennessee
Metro Action Commission - Tennessee
Township of Middle Municipality - New Jersey
Monroe Township - New Jersey
Township of Moorestown Municipality - New Jersey
Township of Mount Laurel Municipality - New Jersey
County of Napa, California

EXHIBIT D

CLIENTS OF HASKINS & SELLS

FEDERAL, STATE, MUNICIPAL DEPARTMENTS, AGENCIES OR SUB-DIVISIONS FOR WHICH A SIGNIFICANT AMOUNT OF SERVICES WERE PERFORMED DURING FISCAL YEAR ENDED MAY 31, 1975

MUNICIPAL - (Continued)

City of New Britain-Connecticut
Township of New Hanover Municipality - New Jersey
Township of North Hanover Municipality - New Jersey
Borough of Palmyra Municipality - New Jersey
City of Philadelphia - Pennsylvania
Borough of Pitman Municipality - New Jersey
City of Pontiac - Pontiac General Hospital Fund - Michigan
Borough of Riverton - New Jersey
City of Salem Municipality - New Jersey
Salt Lake City Corporation - Utah
City of San Antonio - Model Cities Program - Texas
Town of Scituate - Massachusetts
Town of Seymour - Connecticut
City of Simi Valley - California
Town of Stratford - Connecticut
Township of Upper Deerfield Municipality - New Jersey
City of Vernon - California
Washington County - Minnesota
Township of West Deptford Municipality - New Jersey
Westchester County Medical Center - Grassland Hospital - New York
Town of Westport - Connecticut
Borough of Wildwood Crest - New Jersey

OTHER

Government of American Samoa
District of Columbia Public Service

Note -

The above list includes those entities for which Haskins & Sells performed a significant amount of services during the fiscal year ended May 31, 1975, with "significant" defined as engagements aggregating fees of $10,000 or more.

EXHIBIT E

CLIENTS OF HASKINS & SELLS

FEDERAL DEPARTMENTS, AGENCIES OR SUB-DIVISIONS
FOR WHICH A SIGNIFICANT AMOUNT OF SERVICES WERE PERFORMED FOR
THE FIVE FISCAL YEARS ENDING JUNE 1, 1974

FISCAL YEAR ENDED MAY 30, 1970
United States Department of Navy

FISCAL YEAR ENDED MAY 29, 1971
United States Department of Navy

FISCAL YEAR ENDED JUNE 3, 1972
Maui Economic Opportunity
United States Department of Navy

FISCAL YEAR ENDED JUNE 2, 1973
Department of Health, Education and Welfare
Price Commission Office of Administration
United States Department of Navy
Maui Economic Opportunity
General Services Administration

FISCAL YEAR ENDED JUNE 1, 1974
Federal Home Loan Bank Board Consolidated
Securities Fund
United States Department of Navy
Comptroller of the Currency

Note -
The above list includes those entities for which Haskins & Sells performed a significant amount of services during the fiscal year ended May 31, 1975, with "significant" defined as engagements aggregating fees of $10,000 or more.

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
345 PARK AVENUE
NEW YORK, NEW YORK 10022

WALTER E. HANSON
SENIOR PARTNER

January 23, 1976

Senator Lee Metcalf
United States Senate
Committee on Government Operations
Washington, D. C. 20510

Dear Senator Metcalf:

In reply to your request of December 19, 1975, I am pleased to enclose the answers to the questionnaire enclosed with that letter. We are pleased to cooperate with your committee in completing this questionnaire, and if there are any clarifying questions, please do not hesitate to let me know.

Sincerely yours,

WEH:ebs

Enclosure

PEAT, MARWICK, MITCHELL & CO.
345 Park Avenue
New York, New York 10022

Questionnaire - Subcommittee on
Reports, Accounting and Management

1) 100 offices

2) 42 states + Guam + Puerto Rico + Washington, D.C. = 45

3) 199 foreign offices

4) 791 partners

5) 90 principals

6) 8,277 employees excluding partners and principals

7) a- 67.7%
b- 21.4
c- 10.9
100.0%

d- 1.0%
e- 4.0% These amounts are included in 7a, b, and c

8) a-f

Peat, Marwick, Mitchell & Co. renders management or other advisory services in all the listed categories.

9) 220 clients on the New York Stock Exchange - listing enclosed

10) 115 clients on the American Stock Exchange - listing enclosed

11) a- 745 other publicly-held corporations not on the New York Stock Exchange or the American Stock Exchange
b- 22,500 non-public clients

Questionnaire - Subcommittee on
Reports, Accounting and Management

12) Not known - AICPA membership is on an individual basis

13) The Firm contributes $200,000 to the Financial Accounting Standards Board each year.

14) The following is a listing of the major categories of Federal departments and agencies for which PMM&Co. performed services in 1975. In addition, PMM&Co. performed services for approximately 1,500 clients categorized as "state, municipal or other government authority":

Department of the Army
Department of Justice
Department of the Navy
Department of Transportation
Environmental Protection Administration
Federal Highway Administration
Federal Home Loan Board
Federal Railroad Administration
General Accounting Office
General Services Administration
Health, Education and Welfare
Housing and Urban Development
National Aeronautics and Space Administration
National Highway Traffic Safety Administration
National Science Foundation
Office of Alien Property
Office of Economic Opportunity
Office of Management and Budget
United States Price Commission

15) Same listing as question #14

16) Amounts are not segregated from Firm totals and therefore not obtainable

17) None in existence

NEW YORK AND AMERICAN STOCK EXCHANGE CLIENTS

PEAT MARWICK MITCHELL & CO

NEW YORK EXCHANGE

ADAMS DRUG COMPANY INC	PAWTUCKET	R I	96,099,467
AETNA LIFE AND CASUALTY CO	HARTFORD	CONN	5,172,634,000
AGUIRRE CO	NEW YORK	N Y	14,341,782
ALASKA INTERSTATE CO	HOUSTON	TEX	162,319,894
ALBERTO-CULVER CO	MELROSE PARK	ILL	152,428,429
ALLEGHANY CORP	NEW YORK	N Y	12,606,154
ALLEGHENY LUDLUM INDUSTRIES INC	PITTSBURGH	PA	995,154,000
AMERICAN AIR FILTER COMPANY INC	LOUISVILLE	KY	187,824,107
AMERICAN BROADCASTING COMPANIES INC	NEW YORK	N Y	986,040,000
AMERICAN CENTURY MORTGAGE INVESTORS	JACKSONVILLE	FLA	17,485,497
AMERICAN CYANAMID CO	WAYNE	N J	1,779,872,000
AMERICAN FAMILY CORP	COLUMBUS	GA	52,096,146
AMERICAN STORES CO	WILMINGTON	DEL	2,320,322,000
ANDERSON CLAYTON & CO	HOUSTON	TEX	891,558,000
APCO OIL CORP	HOUSTON	TEX	230,937,504
ARMSTRONG CORK CO	LANCASTER	PA	887,166,000
ATHLONE INDUSTRIES INC	PARSIPPANY	N J	187,969,646
AZTEC OIL & GAS CO	DALLAS	TEX	16,730,121
BAKER INDUSTRIES INC	PARSIPPANY	N J	94,681,840
BANGOR PUNTA CORP	GREENWICH	CONN	264,395,000
BATES MANUFACTURING COMPANY INC	NEW YORK	N Y	138,425,265
BEATRICE FOODS CO	CHICAGO	ILL	3,555,054,988
BORG-WARNER CORP	CHICAGO	ILL	1,552,442,000
BT MORTGAGE INVESTORS	BOSTON	MASS	18,290,000
THE BUDD CO	TROY	MICH	871,833,000
BUDGET INDUSTRIES INC	LOS ANGELES	CALIF	50,648,139
BULOVA WATCH COMPANY INC	NEW YORK	N Y	213,773,009
BURLINGTON INDUSTRIES INC	GREENSBORO	N C	2,329,971,000
C I MORTGAGE GROUP	BOSTON	MASS	34,244,379
C I REALTY INVESTORS	BOSTON	MASS	31,230,619
CADENCE INDUSTRIES CORP	WEST CALDWELL	N J	95,145,000
CAMERON-BROWN INVESTMENT GROUP	RALEIGH	N C	16,680,505
CARLISLE CORP	CINCINNATI	OHIO	123,289,038
CARTER-WALLACE INC	NEW YORK	N Y	152,684,000
CCI CORP	TULSA	OKLA	116,048,000
CELANESE CORP	NEW YORK	N Y	1,928,000,000
CENTRAL MAINE POWER CO	AUGUSTA	MAINE	141,177,360
CHAMPION SPARK PLUG CO	TOLEDO	OHIO	367,377,483

PEAT MARWICK MITCHELL & CO

NEW YORK EXCHANGE

CHARTER CO	JACKSONVILLE	FLA
CHARTER NEW YORK CORP	NEW YORK	N Y
CHASE MANHATTAN CORP	NEW YORK	N Y
CHASE MANHATTAN MORTGAGE AND REALTY TRUS	BOSTON	MASS
CHEMETRON CORP	CHICAGO	ILL
CHESSIE SYSTEM INC	BALTIMORE	MD
CHICAGO MILWAUKEE CORP	CHICAGO	ILL
CHOCK FULL O' NUTS CORP	NEW YORK	N Y
CHROMALLOY AMERICAN CORP	CLAYTON	MO
CITICORP	NEW YORK	N Y
CITIES SERVICE CO	TULSA	OKLA
CITY INVESTING CO	BEVERLY HILLS	CALIF
CLC OF AMERICA INC	CHICAGO	ILL
CNA FINANCIAL CORP	CHICAGO	ILL
COLONIAL STORES INC	EAST POINT	GA
COLWELL MORTGAGE TRUST	LOS ANGELES	CALIF
CONAGRA INC	OMAHA	NEBR
CONTINENTAL AIR LINES INC	LOS ANGELES	CALIF
THE CONTINENTAL CORP	NEW YORK	N Y
CONTROL DATA CORP	MINNEAPOLIS	MINN
CONWOOD CORP	MEMPHIS	TENN
COOPER LABORATORIES INC	PARSIPPANY	N Y
CREDITHRIFT FINANCIAL CORP	EVANSVILLE	IND
CREDITHRIFT FINANCIAL INC	EVANSVILLE	IND
CROMPTON & KNOWLES CORP	NEW YORK	N Y
CURRENT INCOME SHARES INC		
D H BALDWIN CO	CINCINNATI	OHIO
DAN RIVER INC	DANVILLE	VA
DEL E WEBB CORP	PHOENIX	ARIZ
DIAL FINANCIAL CORP	DES MOINES	IOWA
DILLINGHAM CORP	HONOLULU	HAWAII
DILLON COMPANIES INC	HUTCHINSON	KANS
DONALDSON LUFKIN & JENRETTE INC	NEW YORK	N Y
DOVER CORP	NEW YORK	N Y
DPF INC	HARTSDALE	N Y
DR PEPPER CO	DALLAS	TEX
EAGLE-PICHER INDUSTRIES INC	CINCINNATI	OHIO
EMERSON ELECTRIC CO	SAINT LOUIS	MO
ENNIS BUSINESS FORMS INC	ENNIS	TEX
EX-CELL-O CORP	TROY	MICH
FABERGE INC	NEW YORK	N Y
FAIRMONT FOODS CO	OMAHA	NEBR
FAR WEST FINANCIAL CORP	NEWPORT BEACH	CALIF
FARAH MANUFACTURING COMPANY INC	EL PASO	TEX
FERRO CORP	CLEVELAND	OHIO
FIDELITY FINANCIAL CORP	SAN FRANCISCO	CALIF
FIDELITY MORTGAGE INVESTORS	BOSTON	MASS
FIDELITY UNION BANCORPORATION	NEWARK	N J
FIRST MISSISSIPPI CORP	JACKSON	MISS

PEAT MARWICK MITCHELL & CO

NEW YORK EXCHANGE

FIRST NATIONAL CITY CORP	NEW YORK	N Y
FIRST PENNSYLVANIA CORP	PHILADELPHIA	PA
FIRST PENNSYLVANIA MORTGAGE TRUST	BOSTON	MASS
FIRST WISCONSIN CORP	MILWAUKEE	WIS
FMC CORP	CHICAGO	ILL
GAC CORP	MIAMI	FLA
GAMBLE-SKOGMO INC	MINNEAPOLIS	MINN
GANNETT COMPANY INC	ROCHESTER	N Y
GENERAL BANCSHARES CORP	SAINT LOUIS	MO
GENERAL CABLE CORP	GREENWICH	CONN
GENERAL ELECTRIC CO	SCHENECTADY	N Y
GENERAL MILLS INC	MINNEAPOLIS	MINN
GENERAL SIGNAL CORP	NEW YORK	N Y
GENESCO INC	NASHVILLE	TENN
THE GILLETTE CO	BOSTON	MASS
GLOBE-UNION INC	MILWAUKEE	WIS
GORDON JEWELRY CORP	HOUSTON	TEX
GREAT LAKES DREDGE & DOCK CO	CHICAGO	ILL
GREAT WESTERN UNITED CORP	DENVER	COLO
GREEN GIANT CO	LE SUEUR	MINN
GROLIER INC	NEW YORK	N Y
GUARDIAN MORTGAGE INVESTORS	JACKSONVILLE	FLA
GULF MORTGAGE AND REALTY INVESTMENTS	BOSTON	MASS
H F AHMANSON & CO	LOS ANGELES	CALIF
H J HEINZ CO	PITTSBURGH	PA
HARDEE'S FOOD SYSTEMS INC	ROCKY MOUNT	N C
HAWAIIAN ELECTRIC COMPANY INC	HONOLULU	HAWAII
HAYES-ALBION CORP	JACKSON	MICH
IDS REALTY TRUST	MINNEAPOLIS	MINN
ILLINOIS CENTRAL INDUSTRIES INC	CHICAGO	ILL
INDUSTRIAL NATIONAL CORP	PROVIDENCE	R I
INTERCO INC	SAINT LOUIS	MO
INTERNATIONAL MULTIFOODS CORP	MINNEAPOLIS	MINN
IU INTERNATIONAL CORP	PHILADELPHIA	PA
J C PENNEY COMPANY INC	NEW YORK	N Y
JACK ECKERD CORP	CLEARWATER	FLA
KING'S DEPARTMENT STORES INC	NEWTON	MASS
LENNAR CORP	MIAMI	FLA
LIBERTY LOAN CORP	SAINT LOUIS	MO
LONDONTOWN CORP	BALTIMORE	MD
LONDONTOWN MANUFACTURING CO	BALTIMORE	MD
THE LOUISIANA LAND AND EXPLORATION CO	NEW ORLEANS	LA
MARION LABORATORIES INC	KANSAS CITY	MO
MATSUSHITA ELECTRIC INDUSTRIAL CO LTD		
MELVILLE SHOE CORP	HARRISON	N Y
MEREDITH CORP	DES MOINES	IOWA
METROMEDIA INC	NEW YORK	N Y
MICHIGAN SEAMLESS TUBE CO	SOUTH LYON	MICH
MIDLAND MORTGAGE INVESTORS TRUST	OKLAHOMA CITY	OKLA

PEAT MARWICK MITCHELL & CO

NEW YORK EXCHANGE

MOBILE HOME INDUSTRIES INC	TALLAHASSEE	FLA
MOHASCO CORP	AMSTERDAM	N Y
MONY MORTGAGE INVESTORS	NEW YORK	N Y
MORSE SHOE INC	CANTON	MASS
MOTOROLA INC	FRANKLIN PARK	ILL
MUNSINGWEAR INC	MINNEAPOLIS	MINN
MURPHY OIL CORP	EL DORADO	ARK
NATIONAL AVIATION CORP	NEW YORK	N Y
NATIONAL SEMICONDUCTOR CORP	SANTA CLARA	CALIF
NATIONAL-STANDARD CO	NILES	MICH
NEPTUNE INTERNATIONAL CORP	ATLANTA	GA
NORFOLK AND WESTERN RAILWAY CO	ROANOKE	VA
NORTH AMERICAN MORTGAGE INVESTORS	BOSTON	MASS
NORTHEAST UTILITIES	WEST SPRINGFIELD	MASS
NORTHWEST BANCORPORATION	MINNEAPOLIS	MINN
NVF CO	YORKLYN	DEL
OKLAHOMA NATURAL GAS CO	TULSA	OKLA
OLIN CORP	STAMFORD	CONN
OLINKRAFT INC	WEST MONROE	LA
OTIS ELEVATOR CO	NEW YORK	N Y
P R MALLORY & COMPANY INC	INDIANAPOLIS	IND
PANHANDLE EASTERN PIPE LINE CO	HOUSTON	TEX
PAY LESS DRUG STORES NORTHWEST INC	PORTLAND	OREGON
PEABODY GALION CORP	NEW YORK	N Y
PHILADELPHIA SUBURBAN CORP	BRYN MAWR	PA
THE PITTSTON CO	NEW YORK	N Y
POLAROID CORP	CAMBRIDGE	MASS
POTLATCH CORP	SAN FRANCISCO	CALIF
PREMIER INDUSTRIAL CORP	CLEVELAND	OHIO
PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE	MANCHESTER	N H
PUBLIC SERVICE COMPANY OF NEW MEXICO	ALBUQUERQUE	N MEX
PUEBLO INTERNATIONAL INC	SAN JUAN	PUERTO RIC
PUROLATOR INC	RAHWAY	N J
QUESTOR CORP	TOLEDO	OHIO
READING CO	PHILADELPHIA	PA
REICHHOLD CHEMICALS INC	WHITE PLAINS	N Y
REPUBLIC FINANCIAL SERVICES INC	DALLAS	TEX
REVCO D S INC	CLEVELAND	OHIO
REVLON INC	NEW YORK	N Y
RIVIANA FOODS INC	HOUSTON	TEX
ROCKOWER BROTHERS INC	HUNTINGDON VALLEY	PA
ROHM AND HAAS CO	PHILADELPHIA	PA
RUBBERMAID INC	WOOSTER	OHIO
RYDER SYSTEM INC	MIAMI	FLA
SAFEWAY STORES INC	OAKLAND	CALIF
SAV-A-STOP INC	JACKSONVILLE	FLA
SIMMONDS PRECISION PRODUCTS INC	TARRYTOWN	N Y
THE SINGER CO	NEW YORK	N Y
SMITHKLINE CORP	PHILADELPHIA	PA

PEAT MARWICK MITCHELL & CO

NEW YORK EXCHANGE		
SOUTHEASTERN PUBLIC SERVICE CO	MIAMI BEACH	FLA
SOUTHERN UNION GAS CO	DALLAS	TEX
SOUTHWESTERN PUBLIC SERVICE CO	AMARILLO	TEX
SQUIBB CORP	NEW YORK	N Y
STANDARD BRANDS PAINT CO	TORRANCE	CALIF
STANDARD PRESSED STEEL CO	JENKINTOWN	PA
STANDARD PRUDENTIAL CORP	NEW YORK	N Y
STOP & SHOP COMPANIES INC	SOUTH BOSTON	MASS
SYSTRON-DONNER CORP	CONCORD	CALIF
TAFT BROADCASTING CO	CINCINNATI	OHIO
TEXAS EASTERN TRANSMISSION CORP	HOUSTON	TEX
TEXAS PACIFIC LAND TRUST	NEW YORK	N Y
TEXASGULF INC	NEW YORK	N Y
THOMAS & BETTS CORP	ELIZABETH	N J
TIDEWATER MARINE SERVICE INC	NEW ORLEANS	LA
TRE CORP	BEVERLY HILLS	CALIF
TWENTIETH CENTURY-FOX FILM CORP	LOS ANGELES	CALIF
THE UMET TRUST	BEVERLY HILLS	CALIF
UNION BANCORP INC	LOS ANGELES	CALIF
UNION FIDELITY CORP	TREVOSE	PA
UNIONAMERICA INC	LOS ANGELES	CALIF
UNITED JERSEY BANKS	PRINCETON	N J
UNITED NUCLEAR CORP	ELMSFORD	N Y
USLIFE CORP	NEW YORK	N Y
USLIFE INCOME FUND INC	NEW YORK	N Y
VORNADO INC	GARFIELD	N J
WACHOVIA REALTY INVESTMENTS	COLUMBIA	S C
WAYNE-GOSSARD CORP	HUMBOLDT	TENN
WELLS FARGO & CO	SAN FRANCISCO	CALIF
WESCO FINANCIAL CORP	PASADENA	CALIF
WESTERN AIR LINES INC	LOS ANGELES	CALIF
THE WHEELING AND LAKE ERIE RAILWAY CO	ROANOKE	VA
WINN-DIXIE STORES INC	JACKSONVILLE	FLA
WOODS CORP	OKLAHOMA CITY	OKLA
XEROX CORP	STAMFORD	CONN
AMERICAN EXCHANGE		
THE AAV COMPANIES	SOLON	OHIO
ADOBE OIL & GAS CORP	MIDLAND	TEX
AFFILIATED CAPITAL CORP	HOUSTON	TEX
ALLEGHENY AIRLINES INC	WASHINGTON	D C
AMERICAN MOTOR INNS INC	ROANOKE	VA
AMERICAN PETROFINA INC	NEW YORK	N Y
APPLIED DATA RESEARCH INC	PRINCETON	N J
AVEMCO CORP	BETHESDA	MD
AVONDALE MILLS	SYLACAUGA	ALA
BARTH-SPENCER CORP	VALLEY STREAM	N Y
BARUCH-FOSTER CORP	DALLAS	TEX

PEAT MARWICK MITCHELL & CO

AMERICAN EXCHANGE

.BERG ENTERPRISES REALTY GROUP	NEW YORK	N Y
BINKS MANUFACTURING CO	FRANKLIN PARK	ILL
THE BOHACK CORP	BROOKLYN	N Y
BRO-DART INDUSTRIES	NEW BRUNSWICK	N J
BUELL INDUSTRIES INC	WATERBURY	CONN
C BREWER AND COMPANY LTD	HONOLULU	HAWAII
CANADIAN EXPORT GAS & OIL LTD		
CANADIAN HOMESTEAD OILS LTD		
CDI CORP	PHILADELPHIA	PA
CENTRAL SECURITIES CORP	NEW YORK	N Y
CINERAMA INC	LOS ANGELES	CALIF
THE CIRCLE K CORP	EL PASO	TEX
CMI CORP	OKLAHOMA CITY	OKLA
COLONIAL COMMERCIAL CORP	VALLEY STREAM	N Y
COLWELL CO	LOS ANGELES	CALIF
COMMUNITY PUBLIC SERVICE CO	FORT WORTH	TEX
COMPUTER INVESTORS GROUP INC	STAMFORD	CONN
CONSOLIDATED REFINING COMPANY INC	MAMARONECK	N Y
COOPER-JARRETT INC	ORANGE	N J
CRAIG CORP	COMPTON	CALIF
DATA DOCUMENTS INC	OMAHA	NEBR
DEL LABORATORIES INC	FARMINGDALE	N Y
DESIGNCRAFT JEWEL INDUSTRIES INC	NEW YORK	N Y
DISCOUNT FABRICS INC	PORTLAND	OREGON
DOWNEY SAVINGS AND LOAN ASSOCIATION	DOWNEY	CALIF
EDO CORP	COLLEGE POINT	N Y
ESPEY MFG & ELECTRONICS CORP	GREAT NECK	N Y
THE FED-MART CORP	SAN DIEGO	CALIF
FLAGSTAFF CORP	NEW YORK	N Y
GATEWAY SPORTING GOODS CO	KANSAS CITY	MO
GENERAL EDUCATIONAL SERVICES CORP	LOS ANGELES	CALIF
GERBER SCIENTIFIC INSTRUMENT CO	SOUTH WINDSOR	CONN
GREAT SCOTT SUPER MARKETS INC	DETROIT	MICH
HALL'S MOTOR TRANSIT CO	MECHANICSBURG	PA
HASBRO INDUSTRIES INC	PAWTUCKET	R I
HIPOTRONICS INC	BREWSTER	N Y
HOFMANN INDUSTRIES INC	SINKING SPRING	PA
HUDSON'S BAY OIL AND GAS CO LTD		
HUFFMAN MANUFACTURING CO	MIAMISBURG	OHIO
HUSKY OIL LTD		
HYGRADE FOOD PRODUCTS CORP	SOUTHFIELD	MICH
I C H CORP	KANSAS CITY	MO
ICM REALTY	NEW YORK	N Y
INTERNATIONAL FUNERAL SERVICES INC	DES MOINES	IOWA
INVESTMENT CORPORATION OF FLORIDA	FORT LAUDERDALE	FLA
INVESTORS DIVERSIFIED SERVICES INC	MINNEAPOLIS	MINN
INVESTORS REALTY TRUST	NASHVILLE	TENN
ISC INDUSTRIES INC	KANSAS CITY	MO
ITEL CORP	SAN FRANCISCO	CALIF

PEAT MARWICK MITCHELL & CO

AMERICAN EXCHANGE

KANEB SERVICES INC	HOUSTON	TEX
KNOTT HOTELS CORP	NEW YORK	N Y
LANDMARK LAND COMPANY INC	OKLAHOMA CITY	OKLA
LEWIS BUSINESS FORMS INC	JACKSONVILLE	FLA
LINCOLN AMERICAN CORP	LAKE SUCCESS	N Y
LUNDY ELECTRONICS & SYSTEMS INC	GLEN HEAD	N Y
MATERIALS RESEARCH CORP	ORANGEBURG	N Y
MCKEON CONSTRUCTION	SACRAMENTO	CALIF
MEDENCO INC	HOUSTON	TEX
MOOG INC	EAST AURORA	N Y
MORTGAGE GROWTH INVESTORS	BOSTON	MASS
MORTON'S SHOE STORES INC	BOSTON	MASS
MPO VIDEOTRONICS INC	NEW YORK	N Y
NEISNER BROTHERS INC	ROCHESTER	N Y
NEONEX INTERNATIONAL LTD		
NIAGARA FRONTIER SERVICES INC	BUFFALO	N Y
NJB PRIME INVESTORS	CLIFTON	N J
NORTH CANADIAN OILS LTD		
OEA INC	DES PLAINES	ILL
PLANTRONICS INC	SANTA CLARA	CALIF
PRUDENT REAL ESTATE TRUST	NEW YORK	N Y
R G BARRY CORP	COLUMBUS	OHIO
RACON INC	WICHITA	KANS
RAYMOND PRECISION INDUSTRIES INC	MIDDLETOWN	CONN
REEVES TELECOM CORP	CHARLESTON	S C
REFRIGERATED TRANSPORT COMPANY INC	FOREST PARK	GA
REPUBLIC NEW YORK CORP	NEW YORK	N Y
ROBINTECH INC	FORT WORTH	TEX
ROCKAWAY CORP	ROCKAWAY	N J
ROCKWOOD COMPUTER CORP	ELMSFORD	N Y
ROCKWOOD NATIONAL CORP	ELMSFORD	N Y
ROLAND INTERNATIONAL CORP	MIAMI	FLA
S-G SECURITIES INC	BOSTON	MASS
SAFETRAN SYSTEMS CORP	LOUISVILLE	KY
SAN JOSE WATER WORKS	SAN JOSE	CALIF
SEABOARD ALLIED MILLING CORP	NEWTON	MASS
SECURITY PLASTICS INC	MIAMI LAKES	FLA
SERVISCO	HILLSIDE	N J
SPECTOR INDUSTRIES INC	CHICAGO	ILL
STERLING ELECTRONICS CORP	HOUSTON	TEX
STERLING EXTRUDER CORP	SOUTH PLAINFIELD	N J
THE TEXSTAR CORP	GRAND PRAIRIE	TEX
THOROFARE MARKETS INC	YOUNGSTOWN	OHIO
TRANSPORT POOL CORP	BALA CYNWYD	PA
U S RUBBER RECLAIMING COMPANY INC	VICKSBURG	MISS
UNITED STATES RADIUM CORP	MORRISTOWN	N J
UNITY BUYING SERVICE COMPANY INC	HICKSVILLE	N Y
UNIVERSITY SAVINGS ASSOCIATION	HOUSTON	TEX
VAN DORN CO	CLEVELAND	OHIO

PEAT MARWICK MITCHELL & CO

AMERICAN EXCHANGE

VARO INC	GARLAND	TEX
VIATECH INC	SYOSSET	N Y
VOPLEX CORP	PITTSFORD	N Y
WARDS COMPANY INC	RICHMOND	VA
WILLIAMHOUSE-REGENCY INC	NEW YORK	N Y
WILSON BROTHERS	MIAMI BEACH	FLA

161 RUSSELL BUILDING
(202) 224-1474

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

30 January 1976

Mr. Walter E. Hanson
Senior Partner
Peat, Marwick, Mitchell & Company
345 Park Avenue
New York, New York 10022

Dear Mr. Hanson:

I was pleased to receive your response to this subcommittee's accounting questionnaire on 23 January. There were some ommissions and discrepancies which I hope you will clarify.

The answer given for question 16 concerning the amount of revenues your firm has received from each of the Federal agencies listed in response to questions 14 and 15 was: "Amounts are not segregated from Firm totals and therefore not obtainable."

In view of the fact that your firm is a recognized expert in record-keeping for the companies retaining Peat, Marwick, Mitchell & Company as independent auditor, I had hoped that the firm's own records would be kept in sufficient detail to locate this information. Records at other accounting firms are kept in a manner which allows easy computer retrieval of information on government clients.

In order for this subcommittee to evaluate the relationship between Federal agencies and accounting firms, it is necessary that we have data on the amount of Federal money which is being spent by each agency on accounting firm contracts. It would be most helpful to the subcommittee if your staff would exert some extra effort in retrieving this information for us.

Mr. Walter E. Hanson
30 January 1976
Page Two

Your response also stated that among the major categories of Federal departments and agencies for which your company performed services in 1975 and previous years were the Price Commission, the Office of Alien Property and the Office of Economic Opportunity. The Price Commission was terminated by Executive Order # 11695 on 11 January, 1973. The Office of Alien Property was terminated, by Executive Order # 11281 on 13 May, 1966, effective 30 June, 1966. (The foreign fund control section was transferred to the Office of Foreign Assets Control in the Treasury Department and other functions to the civil division of the Department of Justice.) All OEO programs except three were transferred by administrative action to three major departments on 6 July, 1973 and the three remaining programs (Community Action, Economic Development and Legal Services) were transferred to the Community Services Administration by act of 4 January, 1975 (88 Stat. 2310; 42 U.S.C. 2941). Please explain your statement that Peat, Marwick performed services for agencies which no longer existed.

Your cooperation is appreciated.

Very truly yours,

ORIGINAL SIGNED BY
LEE METCALF

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
345 PARK AVENUE
NEW YORK, NEW YORK 10022

WALTER E. HANSON
SENIOR PARTNER

March 8, 1976

Senator Lee Metcalf
United States Senate
Committee on Government
Operations
Washington, D. C. 20510

Dear Senator Metcalf:

In your letter of January 30, 1976, you requested additional information in connection with the Committee on Government Operations. We pride ourselves in having a well-managed firm and have developed our accounting and management information system to provide the data necessary for making effective management decisions. As such, we avoid developing information which has no management value to us. The information you requested regarding annual gross revenues from services performed for Federal departments, etc. falls into this latter category. To cooperate with your committee, however, we have expended substantial personnel and computer time in the development of this information specifically for the Senate subcommittee.

In response to question 16, the annual gross revenues from services performed for Federal departments, etc. were as follows:

Period	Amount
Year ended June 30, 1975	$4,020,000.
" " " " 1974	3,250,000.
" " " " 1973	2,970,000.
" " " " 1972	3,540,000.
" " " " 1971	4,310,000.

While you requested this information on a calendar year basis, the above data has been developed on our regular June 30 fiscal year. We do not consider it economically feasible to restate this information on a calendar basis.

In addition to the information regarding revenues, you also requested clarification regarding services performed for agencies which no longer exist. Under the PMM&Co. accounting system, a client is considered an active client until all phases of an engagement are completed. Consequently, even if no additional services were performed, a client is considered active if any uncollected billings remain outstanding. In the case of the Price Commission and the Office of Economic Opportunity, no additional services were performed subsequent to 1973. However, final billings were collected subsequent to that time. For example, a 1972 billing to OEO was not collected until June 27, 1975 due to internal delays brought about by the wind-down of their affairs.

With respect to the Office of Alien Property, we are still performing services for that unit as a part of the Department of Justice. This unit is reflected in our records as the Office of Alien Property to delineate it from other engagements performed for the Department of Justice. This treatment is consistent with that used to identify a subsidiary from the parent company in the corporate environment.

We trust this will provide the committee with the information necessary to complete its deliberations.

Very truly yours,

WEH:EWR

Price Waterhouse & Co.

1251 AVENUE OF THE AMERICAS NEW YORK NEW YORK 10020
212-489-8900

December 30, 1975

The Honorable Lee Metcalf
Chairman, Subcommittee on
Reports, Accounting, and Management
United States Senate
151 Russell Building
Washington, D. C. 20510

My dear Senator Metcalf:

This is to acknowledge receipt of your letter of December 19 enclosing a questionnaire concerning certain of the activities of my firm. The firm of Price Waterhouse & Co. is pleased to cooperate and accordingly we have already commenced a study of the questionnaire. Unfortunately, some of the information called for will require extensive analysis of our records. As soon as we have made a review of our records for the purpose of determining the feasibility of providing answers to your questionnaire, we will be in touch with you.

I would like to take this opportunity to comment on one matter of concern to me. In the third paragraph of your letter you state:

> "The SEC has formalized this dependence in Accounting Series Release No. 150 which states that the Commission will generally respect and endorse the rulings of the Financial Accounting Standards Board - <u>a body established and largely funded by the accounting profession to set accounting standards for the profession</u>."

I respectfully suggest that the underscored portion of the foregoing quoted material displays less than a full understanding as to the nature of the FASB. I think I can speak with some modest authority on this subject since I was a member of the Wheat Committee which studied the establishment of accounting standards and recommended the formation of the FASB. In addition, I have been, since its formation, a Trustee of the Financial Accounting Foundation, of which the FASB is a part.

The Honorable Lee Metcalf - 2 - December 30, 1975

In the first place, it is probably not quite correct to say that the FASB was established by the accounting profession. The fact is that the FASB is an independent body in the private sector which is established under the auspices of no less than five sponsoring organizations, of which the organized accounting profession is only one. Those five sponsoring organizations are:

American Accounting Association
American Institute of Certified Public Accountants
Financial Executives Institute
Financial Analysts Federation
National Association of Accountants

It seems to me with such broadly based sponsorship one would not wish to imply that the FASB is established by the accounting profession itself.

Secondly, I respectfully point out that the statement to the effect that the Financial Accounting Standards Board is largely funded by the accounting profession is not borne out by the facts. I believe that you will find that only approximately one-half of the funding of the FASB comes from the accounting profession and the other half comes from some 1,300 companies in the industrial sector, plus such organizations as the New York Stock Exchange. In addition, financial support is received from the American Accounting Association, an organization which mainly consists of academic accountants; the NAA, which consists mainly of accountants in industry; and the FAF, which, of course, represents professional financial analysts.

One further thought. The material quoted above states that the FASB will set accounting standards for the profession. I believe that this is a somewhat truncated view of its role since fundamentally the FASB is charged with the establishment of accounting standards to be followed by issuers of financial statements, that is, all of industry. It is well established that the primary responsibility for the fairness of financial statements and their compliance with FASB standards rests with the issuers thereof and that the role of the accounting profession is limited to examining those statements and expressing an independent opinion thereon.

Price Waterhouse

The Honorable Lee Metcalf - 3 - December 30, 1975

In that sense the accounting profession, in carrying out the attest function, performs an important but clearly oversight role. It would perhaps be a better statement of the facts to say that the primary role of the FASB is to establish financial accounting standards for the guidance of issuers of financial statements - it being understood that such standards are also for the guidance of the accounting profession in carrying out its attest function with respect to such statements.

I hope my comments may be helpful to you and your subcommittee.

Sincerely,

John C. Biegler

John C. Biegler

Price Waterhouse & Co.

Price Waterhouse & Co.

1251 AVENUE OF THE AMERICAS, NEW YORK, NEW YORK 10020
212-489-8900

February 18, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on
Reports, Accounting and Management
United States Senate
151 Russell Building
Washington, D. C. 20510

My dear Senator Metcalf:

In accordance with the request contained in your letter of December 19, 1975, I enclose the answers to a questionnaire which accompanied your letter.

Very truly yours,

John C. Biegler

ANSWERS TO QUESTIONNAIRE SUBMITTED TO PRICE WATERHOUSE & CO. (PW) BY THE REPORTS, ACCOUNTING AND MANAGEMENT SUBCOMMITTEE OF THE SENATE COMMITTEE ON GOVERNMENT OPERATIONS

1. Please state the number of offices which your firm maintains within the United States (If more than one partnership, corporation or other entity exists in the United States, please furnish all names and answer subsequent questions accordingly.)

    PW has 67 offices in the United States.

2. Please indicate the number of states, territories or possessions of the United States in which your firm maintains an office or affiliated office.

    PW has offices in 32 states and in Puerto Rico.

3. Please state the number of cities outside the United States in which your firm maintains offices or has an affiliation.

    PW or its affiliates have offices in 203 cities outside the United States.

4. Please state the number of partners in your firm located in the United States (include only certified public accountants).

    PW has 348 partners (CPAs) in the United States.

5. Please state the number of principals located in your offices in the United States who are not certified public accountants.

    PW has 18 principals (almost entirely Management Advisory Services personnel) located in offices in the United States. (These people are not CPAs, but meet all other standards required for partners.)

6. Please state the total number of employees of your firm within the United States, excluding only partners and principals.

    PW has 5,933 employees within the United States exclusive of partners and principals (at January 31, 1976). Of these, 4,654 are professionals and 1,279 are nonprofessionals such as secretaries, receptionists, file clerks, etc. and other administrative support personnel.

7. Please indicate the approximate percentage of total revenues for services performed by your firm in the following categories:

   A. Auditing and accounting
   B. Tax services
   C. Management advisory services including executive, recruitment, product analysis, marketing analysis, and plant layout
   D. Actuarial services
   E. Services performed for Federal, State or local governments
   F. Other

	Percentage of total revenues
A. Auditing and accounting	76%
B. Tax services	16
C. Management advisory services*	6
D. Actuarial services	-
E. Services performed for Federal State or local governments	2
F. Other services	-
	100%

*Does not include product analysis, marketing analysis, and plant layout. (The firm does not render these services.)

8. Please state if your firm renders management or other advisory services in the following categories:

   A. Executive recruitment
   B. Marketing analysis
   C. Plant layout
   D. Product analysis
   E. Actuarial services
   F. Federal advisory committees

   PW renders management services in executive recruitment (limited to accounting and financially oriented administrative positions). PW does no work in the areas of market analysis, plant layout, product analysis, actuarial services or federal advisory committees. (In the context of the question, we assume that "federal advisory committees" refers to client services only.)

9. Please state the name and address of corporations listed on the New York Stock Exchange for which your firm is the independent auditor.

   A list of PW's NYSE clients is attached as Exhibit A.

10. Please state the name and address of corporations listed on the American Stock Exchange for which your firm is the independent auditor.

    A list of PW's AMEX clients is attached as Exhibit B.

11. Please state the number of other publicly-held corporations for which your firm is the independent auditor, and the number of privately held corporations for which your firm is the independent auditor.

    PW is the independent auditor for 523 other publicly-held (SEC registered) companies. PW is the independent auditor for 4,787 privately-held corporations. (Does not include nonprofit corporations nor clients that are not corporations.)

12. Please indicate the total number of partners, principals and employees of your firm who are members of the American Institute of Certified Public Accountants.

    We estimate that at December 31, 1975, 2,200 PW partners and staff were members of the American Institute of Certified Public Accountants.

13. Please state if your firm has made financial contributions, directly or indirectly, to the Financial Accounting Standards Board. If so, please indicate the amount of contributions made annually to date.

    PW made contributions of $200,000 to the Financial Accounting Standards Board in 1973, 1974 and 1975 (total $600,000 to date).

14. Please identify the departments, agencies or subdivisions of any federal, state, municipal or other government authority for which your firm performed any services during 1975.

    A list of the departments, agencies or subdivisions of federal, state and local governments for which PW rendered services in the year ended June 30, 1975 is attached as Exhibit C. (Our records are maintained on a June 30 fiscal year.)

15. Please identify the federal departments, agencies, subdivisions or authorities for which your firm has performed services during each year from January 1, 1970 through December 31, 1974.

    A list showing federal departments, agencies, subdivisions and authorities for which PW performed services during each year from June 30, 1970 through June 30, 1975 is attached as Exhibit D.

16. Please state your firm's annual gross revenue from services performed for Federal departments, agencies, subdivisions or authorities during each year from January 1, 1970 to December 31, 1975.

Annual gross revenues from the Federal Government for years 1970 through 1975 follow:

Year ended June 30, 1970	$ 2,000
" " " " 1971	52,000
" " " " 1972	69,000
" " " " 1973	258,000
" " " " 1974	172,000
" " " " 1975	1,320,000
Six months ended December 31, 1975	385,000

17. Please state if your firm maintains a department, division or office for the procurement of Federal, State and local government contracts. If so, please indicate the name of the person(s) in charge of said department, division or office, and address of such office(s).

PW maintains an Office of Government Services. This office, which is a part of the firmwide function of our National Office, is directly responsible for the coordination of our services to clients which involve direct relationships with government agencies and departments. Similarly, the Office of Government Services is responsible for the direction and coordination of our services to government at all levels. Mr. Roscoe L. Egger, Jr. is partner in charge of the office. Mr. Paul B. Goodstat, a principal, is in charge of the Federal government activity. Mr. Benton B. Warder, a partner, is in charge of the state and local government activity. The address of the office is 1801 K Street, N.W., Washington, D.C. 20006.

EXHIBIT A
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PRICE WATERHOUSE & CO.

NEW YORK STOCK EXCHANGE CLIENTS

AUDITOR NAME - PRICE WATERHOUSE & CO EXCHANGE - NYSE

Listing includes all clients whose common stock is traded on the exchange.

COMPANY NAME	STATE (PRINCIPAL OFFICE)	CITY (PRINCIPAL OFFICE)	ZIP (PRINCIPAL OFFICE)
ACF INDUSTRIES INC	N Y	NEW YORK	10017
ADDRESSOGRAPH-MULTIGRAPH CORP	OHIO	CLEVELAND	44122
ADVANCE INVESTORS CORP	N Y	NEW YORK	10022
ALCAN ALUMINIUM LTD	CANADA	MONTREAL	
ALLEGHENY POWER SYSTEM INC	N Y	NEW YORK	10022
ALLIED CHEMICAL CORP	N J	MORRISTOWN	07960
ALLIS-CHALMERS CORP	WIS	MILWAUKEE	53201
AMCORD INC	CALIF	NEWPORT BEACH	92663
AMERICAN DISTRICT TELEGRAPH CO	N Y	NEW YORK	10013
AMERICAN WATER WORKS COMPANY INC	DEL	WILMINGTON	19807
AMPCO-PITTSBURGH CORP	PA	PITTSBURGH	15219
AMSTED INDUSTRIES INC	ILL	CHICAGO	60601
ANCHOR HOCKING CORP	OHIO	LANCASTER	43130

EXHIBIT A
Page 2

AUDITOR NAME - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	STATE	PRINCIPAL OFFICE CITY	ZIP
AVERY PRODUCTS CORP	CALIF	SAN MARINO	91108
BALL CORP	IND	MUNCIE	47302
BANCAL TRI-STATE CORP	CALIF	SAN FRANCISCO	94104
BANKERS TRUST NEW YORK CORP	N Y	NEW YORK	10017
BAUSCH & LOMB INC	N Y	ROCHESTER	14601
BAYUK CIGARS INC	PA	PHILADELPHIA	19122
BECKMAN INSTRUMENTS INC	CALIF	FULLERTON	92634
BEMIS COMPANY INC	MINN	MINNEAPOLIS	55402
BETHLEHEM STEEL CORP	PA	BETHLEHEM	18016
BORDEN INC	N Y	NEW YORK	10017
BORMAN'S INC	MICH	DETROIT	48228
BRISTOL-MYERS CO	N Y	NEW YORK	10022
BUILDERS INVESTMENT GROUP	PA	VALLEY FORGE	19481

EXHIBIT A
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AUDITOR NAME - PRICE WATERHOUSE & CO

EXCHANGE - NYSE

COMPANY NAME	PRINCIPAL OFFICE STATE	PRINCIPAL OFFICE CITY	PRINCIPAL OFFICE ZIP
BUNKER HILL INCOME SECURITIES INC	CALIF	LOS ANGELES	90069
BURROUGHS CORP	MICH	DETROIT	48232
CAMPBELL SOUP CO	N J	CAMDEN	08101
CANADIAN PACIFIC LTD	QUEBEC	MONTREAL	
CARBORUNDUM CO	N Y	NIAGARA FALLS	14302
CARLING O'KEEFE LTD	ONT	TORONTO	
CARTER HAWLEY HALE STORES INC	CALIF	LOS ANGELES	90014
CATERPILLAR TRACTOR CO	ILL	PEORIA	61629
CENTRAL HUDSON GAS & ELECTRIC CORP	N Y	POUGHKEEPSIE	12602
CERRO CORP	N Y	NEW YORK	10022
CHASE CONVERTIBLE FUND OF BOSTON INC	MASS	BOSTON	02116
CHEMICAL NEW YORK CORP	N Y	NEW YORK	10015
CHICAGO ROCK ISLAND AND PACIFIC RAILROAD CO	ILL	CHICAGO	60605

EXHIBIT A
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AUDITOR NAME - PRICE WATERHOUSE & CO EXCHANGE - NYSE

COMPANY NAME	PRINCIPAL OFFICE STATE	CITY	ZIP
CHICAGO & EASTERN ILLINOIS RAILROAD CO	ILL	CHICAGO	60603
CHICAGO PNEUMATIC TOOL CO	N Y	NEW YORK	10017
CLARK EQUIPMENT CO	MICH	BUCHANAN	49107
CLEVELAND ELECTRIC ILLUMINATING CO	OHIO	CLEVELAND	44101
CNA-LARWIN INVESTMENT CO	N Y	NEW YORK	10017
COLECO INDUSTRIES INC	CONN	HARTFORD	06105
COLUMBIA PICTURES INDUSTRIES INC	N Y	NEW YORK	10022
COMBINED COMMUNICATIONS CORP	ARIZ	PHOENIX	85004
CONNECTICUT GENERAL MORTGAGE AND REALTY INVESTMENT S	MASS	SPRINGFIELD	01115
CONSOLIDATED EDISON COMPANY OF NEW YORK INC	N Y	NEW YORK	10003
CONSOLIDATED NATURAL GAS CO	N Y	NEW YORK	10020
CONTINENTAL INVESTMENT CORP	MASS	BOSTON	02110
CONTINENTAL MORTGAGE INVESTORS	MASS	BOSTON	02110

EXHIBIT A
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AUDITOR N[illegible] - PRICE WATERHOUSE & CO [illegible]XCHANGE - NYSE

COMPANY NAME	STATE	CITY	ZIP
COOPER INDUSTRIES INC	TEX	HOUSTON	77002
CORNING GLASS WORKS	N Y	CORNING	14830
CROWN CORK & SEAL COMPANY INC	PA	PHILADELPHIA	19136
CYCLOPS CORP	PA	PITTSBURGH	15228
DANA CORP	OHIO	TOLEDO	43697
DART INDUSTRIES INC	CALIF	LOS ANGELES	90048
DATA GENERAL CORP	MASS	SOUTHBOROUGH	01772
DEL MONTE CORP	CALIF	SAN FRANCISCO	94119
DELTEC INTERNATIONAL LTD	BAHAMA	NASSAU	00000
DENTSPLY INTERNATIONAL INC	PA	YORK	17404
DETROIT EDISON CO	MICH	DETROIT	48226
DI GIORGIO CORP	CALIF	SAN FRANCISCO	94111
DIAMOND SHAMROCK CORP	OHIO	CLEVELAND	44114

EXHIBIT A
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AUDITOR E - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	STATE	PRINCIPAL OFFICE CITY	ZIP
DIVERSIFIED MORTGAGE INVESTORS	MASS	BOSTON	02109
DORR-OLIVER INC	CONN	STAMFORD	06904
DREXEL BOND-DEBENTURE TRADING FUND	PA	PHILADELPHIA	19102
E I DU PONT DE NEMOURS AND CO	DEL	WILMINGTON	19898
EARLE M JORGENSEN CO	CALIF	LYNWOOD	90262
EASCO CORP	MD	BALTIMORE	21201
EASTERN AIR LINES INC	N Y	NEW YORK	10020
EASTMAN KODAK CO	N Y	ROCHESTER	14650
ELGIN NATIONAL INDUSTRIES INC	ILL	CHICAGO	60606
ELTRA CORP	N Y	NEW YORK	10001
EMERY AIR FREIGHT CORP	CONN	WILTON	06897
EQUIMARK CORP	PA	PITTSBURGH	15222
EXXON CORP	N Y	NEW YORK	10020

EXHIBIT A
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AUDITOR [illegible]E - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	STATE	........PRINCIPAL OFFICE........ CITY	ZIP
F W WOOLWORTH CO	N Y	NEW YORK	10007
FAIRCHILD CAMERA AND INSTRUMENT CORP	CALIF	MOUNTAIN VIEW	94042
FANSTEEL INC	ILL	NORTH CHICAGO	60064
FIBREBOARD CORP	CALIF	SAN FRANCISCO	94133
FISHER SCIENTIFIC CO	PA	PITTSBURGH	15219
FRANKLIN MINT CORP	PA	FRANKLIN CENTER	19063
GEMINI FUND INC	PA	VALLEY FORGE	19482
GENERAL CIGAR COMPANY INC	N Y	NEW YORK	10016
GENERAL FOODS CORP	N Y	WHITE PLAINS	10625
GENERAL HOST CORP	N Y	NEW YORK	10017
GENERAL STEEL INDUSTRIES INC	MO	ST LOUIS	63114
GENERAL TIRE & RUBBER CO	OHIO	AKRON	44329
GOODYEAR TIRE & RUBBER CO	OHIO	AKRON	44316

EXHIBIT A
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AUDITOR NAME - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	STATE	CITY	ZIP
GREAT WESTERN FINANCIAL CORP	CALIF	BEVERLY HILLS	90211
GULF OIL CORP	PA	PITTSBURGH	15230
HACKENSACK WATER CO	N J	WEEHAWKEN	07087
HAMMERMILL PAPER CO	PA	ERIE	16533
HARNISCHFEGER CORP	WIS	MILWAUKEE	53246
HART SCHAFFNER & MARX	ILL	CHICAGO	60606
HIRAM WALKER-GOODERHAM & WORTS LTD	ONT	WALKERVILLE	
HOERNER WALDORF CORP	MINN	ST PAUL	55114
HOWARD JOHNSON CO	MASS	DORCHESTER	02125
HUYCK CORP	N C	WAKE FOREST	27587
HYDROMETALS INC	TEX	DALLAS	75206
ILLINOIS POWER CO	ILL	DECATUR	62525
INCOME AND CAPITAL SHARES INC	MASS	BOSTON	02116

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AUDITOR NAME - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	STATE	PRINCIPAL OFFICE CITY	ZIP
INGERSOLL-RAND CO	N J	WOODCLIFF LAKE	07675
INLAND CONTAINER CORP	IND	INDIANAPOLIS	46206
INLAND STEEL CO	ILL	CHICAGO	60603
INMONT CORP	N Y	NEW YORK	10036
INSILCO CORP	CONN	MERIDEN	06450
INSPIRATION CONSOLIDATED COPPER CO	N J	MORRISTOWN	07960
INTERLAKE INC	ILL	CHICAGO	60604
INTERNATIONAL BUSINESS MACHINES CORP	N Y	ARMONK	10504
INTERNATIONAL FLAVORS & FRAGRANCES INC	N Y	NEW YORK	10019
INTERNATIONAL HOLDINGS CORP	N Y	NEW YORK	10004
INTERNATIONAL MINING CORP	N Y	NEW YORK	10017
INTERNATIONAL NICKEL COMPANY OF CANADA LTD	N Y	NEW YORK	10004
INTERPACE CORP	N J	PARSIPPANY	07054

EXHIBIT A
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AUDITOR [illegible]E - PRICE WATERHOUSE & CO — EXCHANGE - NYSE

COMPANY NAME	PRINCIPAL OFFICE STATE	PRINCIPAL OFFICE CITY	PRINCIPAL OFFICE ZIP
J WALTER THOMPSON CO	N Y	NEW YORK	10017
JEWELCOR INC	N Y	NEW YORK	10036
JIM WALTER CORP	FLA	TAMPA	33607
JOHNSON CONTROLS INC	WIS	MILWAUKEE	53201
JOY MANUFACTURING CO	PA	PITTSBURGH	15222
KANSAS CITY SOUTHERN INDUSTRIES INC	MO	KANSAS CITY	64105
KELLOGG CO	MICH	BATTLE CREEK	49016
LEAR SIEGLER INC	CALIF	SANTA MONICA	90406
LEHIGH PORTLAND CEMENT CO	PA	ALLENTOWN	18105
LEHMAN CORP	N Y	NEW YORK	10004
LONG ISLAND LIGHTING CO	N Y	MINEOLA	11501
LUCKY STORES INC	CALIF	DUBLIN	94566
LYKES-YOUNGSTOWN CORP	LA	NEW ORLEANS	70130

EXHIBIT A
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AUDITOR [illegible]E - PRICE WATERHOUSE & CO — EXCHANGE - NYSE

COMPANY NAME	STATE	...PRINCIPAL OFFICE... CITY	ZIP
MARINE MIDLAND BANKS INC	N Y	BUFFALO	14203
MATTEL INC	CALIF	HAWTHORNE	90250
MCA INC	CALIF	UNIVERSAL CITY	91608
MCINTYRE MINES LTD	ONT	TORONTO	
MESTA MACHINE CO	PA	WEST HOMESTEAD	15120
MICROWAVE ASSOCIATES INC	MASS	BURLINGTON	01803
MILES LABORATORIES INC	IND	ELKHART	46514
MINNESOTA POWER & LIGHT CO	MINN	DULUTH	55802
MISSISSIPPI RIVER CORP	MO	SAINT LOUIS	63124
MOBILE HOME INDUSTRIES INC	FLA	TALLAHASSEE	32304
MONROE AUTO EQUIPMENT CO	MICH	MONROE	48161
NARCO SCIENTIFIC INDUSTRIES INC	PA	FORT WASHINGTON	19034
NASHUA CORP	N H	NASHUA	03060

EXHIBIT A
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AUDITOR E - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	STATE (PRINCIPAL OFFICE)	CITY (PRINCIPAL OFFICE)	ZIP (PRINCIPAL OFFICE)
NATIONAL CHEMSEARCH CORP	TEX	IRVING	75060
NATIONAL DISTILLERS AND CHEMICAL CORP	N Y	NEW YORK	10016
NATIONAL FUEL GAS CO	N Y	NEW YORK	10020
NATIONAL HOMES CORP	IND	LAFAYETTE	47905
NCR CORP	OHIO	DAYTON	45479
NEWHALL LAND AND FARMING CO	CALIF	VALENCIA	91355
NIAGARA MOHAWK POWER CORP	N Y	SYRACUSE	13202
NIAGARA SHARE CORP	N Y	BUFFALO	14202
NORTHWESTERN MUTUAL LIFE MORTGAGE AND REALTY INVESTORS	WIS	MILWAUKEE	53202
OSCAR MAYER & COMPANY INC	WIS	MADISON	53704
PACIFIC AMERICAN INCOME SHARES INC	CALIF	PASADENA	91109
PAPERCRAFT CORP	PA	PITTSBURGH	15238
PERKIN-ELMER CORP	CONN	NORWALK	06856

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AUDITOR E - PRICE WATERHOUSE & CO EXCHANGE - NYSE

COMPANY NAME	STATE	PRINCIPAL OFFICE CITY	ZIP
PET INC	MO	SAINT LOUIS	63166
PHELPS DODGE CORP	N Y	NEW YORK	10022
PIER 1 IMPORTS INC	TEX	FORT WORTH	76102
PITNEY-BOWES INC	CONN	STAMFORD	06904
PORTEC INC	ILL	OAK BROOK	60521
POTOMAC ELECTRIC POWER CO	D C	WASHINGTON	20006
PRODUCTS RESEARCH & CHEMICAL CORP	CALIF	BURBANK	91505
PUBLICKER INDUSTRIES INC	PA	PHILADELPHIA	19102
PUREX CORP	CALIF	LAKEWOOD	90712
RALSTON PURINA CO	MO	SAINT LOUIS	63188
RAYMOND INTERNATIONAL INC	TEX	HOUSTON	77027
RICHARDSON-MERRELL INC	CONN	WILTON	06897
ROCHESTER GAS AND ELECTRIC CORP	N Y	ROCHESTER	14649

EXHIBIT A
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AUDITOR NAME - PRICE WATERHOUSE & CO | EXCHANGE - NYSE

COMPANY NAME	STATE	CITY	ZIP
ROCHESTER TELEPHONE CORP	N Y	ROCHESTER	14646
ROLLINS INC	GA	ATLANTA	30324
ROYAL DUTCH PETROLEUM CO	HOLLAN	THE HAGUE	
ROYAL INDUSTRIES INC	CALIF	PASADENA	91105
S S KRESGE CO	MICH	TROY	48084
SAGA CORP	CALIF	MENLO PARK	94025
SANDERS ASSOCIATES INC	N H	NASHUA	03060
SANTA FE INDUSTRIES INC	ILL	CHICAGO	60604
SANTA FE INTERNATIONAL CORP	CALIF	ORANGE	92668
SCHLUMBERGER LTD	N Y	NEW YORK	10017
SCOTT PAPER CO	PA	PHILADELPHIA	19113
SEATRAIN LINES INC	N Y	NEW YORK	10005
SERVOMATION CORP	N Y	NEW YORK	10017

EXHIBIT A
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AUDITOR NAME - PRICE WATERHOUSE & CO EXCHANGE - NYSE

COMPANY NAME	STATE	CITY	ZIP
SHELL OIL CO	TEX	HOUSTON	77002
SIMPLICITY PATTERN COMPANY INC	N Y	NEW YORK	10016
SONY CORP	JAPAN	TOKYO	
SOUTHDOWN INC	TEX	HOUSTON	77002
SOUTHERN RAILWAY CO	D C	WASHINGTON	20013
SOUTHWEST FOREST INDUSTRIES INC	ARIZ	PHOENIX	85012
ST LOUIS-SAN FRANCISCO RAILWAY CO	MO	SAINT LOUIS	63101
STANDARD & POOR'S/INTERCAPITAL INCOME SECURITIES INC	N Y	NEW YORK	10019
STANDARD OIL COMPANY OF CALIFORNIA	CALIF	SAN FRANCISCO	94104
STANDARD OIL COMPANY OF INDIANA	ILL	CHICAGO	60601
STATE MUTUAL INVESTORS	MASS	WORCESTER	01605
STATE MUTUAL SECURITIES INC	MASS	WORCESTER	01605
STERLING DRUG INC	N Y	NEW YORK	10016

EXHIBIT A
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AUDITOR NAME - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	PRINCIPAL OFFICE STATE	CITY	ZIP
SUNBEAM CORP	ILL	CHICAGO	60650
SYBRON CORP	N Y	ROCHESTER	14604
TANDY CORP	TEX	FORT WORTH	76107
TANDYCRAFTS INC	TEXAS	FORT WORTH	76107
TECHNICON CORP	N Y	TARRYTOWN	10591
TEXAS INTERNATIONAL CO	OKLA	OKLAHOMA CITY	73112
THE ANACONDA CO	N Y	NEW YORK	10004
THE ANSUL CO	WIS	MARINETTE	54143
THE BABCOCK & WILCOX CO	N Y	NEW YORK	10017
THE CANADA SOUTHERN RAILWAY CO	PA	PHILADELPHIA	19104
THE ECHLIN MANUFACTURING CO	CONN	BRANFORD	06405
THE F & M SCHAEFER CORP	N Y	NEW YORK	10022
THE GRAND UNION CO	N J	EAST PATERSON	07407

EXHIBIT A
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AUDITO[R N]AME - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	STATE (PRINCIPAL OFFICE)	CITY (PRINCIPAL OFFICE)	ZIP (PRINCIPAL OFFICE)
THE INTERPUBLIC GROUP OF COMPANIES INC	N Y	NEW YORK	10020
THE JAPAN FUND INC	N Y	NEW YORK	10020
THE LIONEL CORP	N Y	NEW YORK	10019
THE MONTANA POWER CO	MONT	BUTTE	59701
THE SEAGRAM COMPANY LTD	QUEBEC	MONTREAL	
THE SEAGRAVE CORP	N Y	NEW YORK	10001
THE WESTERN COMPANY OF NORTH AMERICA	TEX	FORT WORTH	76116
THE WESTERN UNION TELEGRAPH CO	N J	UPPER SADDLE RIVER	07458
TI CORPORATION OF CALIFORNIA)	CALIF	LOS ANGELES	90051
TOOTSIE ROLL INDUSTRIES INC	ILL	CHICAGO	60629
TRANE CO	WIS	LA CROSSE	54601
TRI-SOUTH MORTGAGE INVESTORS	GA	ATLANTA	30341
TYCO LABORATORIES INC	MASS	WALTHAM	02154

EXHIBIT A
Page 18

AUDITOR [illegible]E - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	STATE	PRINCIPAL OFFICE CITY	ZIP
UNILEVER N V	NETHER	ROTTERDAM	
UNION ELECTRIC CO	MO	ST LOUIS	63102
UNITED BRANDS CO	N Y	NEW YORK	10017
UNITED FINANCIAL CORPORATION OF CALIFORNIA	CALIF	LOS ANGELES	90045
UNITED PARK CITY MINES CO	UTAH	SALT LAKE CITY	84101
UNITED STATES & FOREIGN SECURITIES CORP	N Y	NEW YORK	10022
UNITED STATES STEEL CORP	N Y	NEW YORK	10006
UNITED TECHNOLOGIES CORP	CONN	HARTFORD	06101
W R GRACE & CO	N Y	NEW YORK	10036
W F HALL PRINTING CO	ILL	CHICAGO	60639
WALT DISNEY PRODUCTIONS	CALIF	BURBANK	91521
WALTER KIDDE & COMPANY INC	N J	CLIFTON	07012
WARD FOODS INC	ILL	WILMETTE	60091

EXHIBIT A
Page 19

AUDITOR NAME - PRICE WATERHOUSE & CO   EXCHANGE - NYSE

COMPANY NAME	PRINCIPAL OFFICE STATE	PRINCIPAL OFFICE CITY	PRINCIPAL OFFICE ZIP
WARNACO INC	CONN	BRIDGEPORT	06602
WARNER-LAMBERT CO	N J	MORRIS PLAINS	07950
WESTERN UNION CORP	N J	MAHWAH	07430
WESTINGHOUSE ELECTRIC CORP	PA	PITTSBURGH	15222
WESTVACO CORP	N Y	NEW YORK	10017
WHEELING-PITTSBURGH STEEL CORP	PA	PITTSBURGH	15230
WISCONSIN ELECTRIC POWER CO	WIS	MILWAUKEE	53201
YOUNGSTOWN STEEL DOOR CO	OHIO	CLEVELAND	44114

***** TOTALS - 242 COMPANIES

EXHIBIT B
Page 1

PRICE WATERHOUSE & CO.

AMERICAN STOCK EXCHANGE CLIENTS

Listing includes all clients whose common stock is traded on the exchange.

AUDITOR [illegible]E - PRICE WATERHOUSE & CO   [illegible]EXCHANGE - AMEX

COMPANY NAME	PRINCIPAL OFFICE STATE	PRINCIPAL OFFICE CITY	PRINCIPAL OFFICE ZIP
A V C CORP	PA	PHILADELPHIA	19102
ALASKA AIRLINES INC	WASH	SEATTLE	98158
ALLIED ARTISTS PICTURES CORP	N Y	NEW YORK	10023
ALLIED THERMAL CORP	CONN	NEW BRITAIN	06050
ANGLO COMPANY LTD	N Y	NEW YORK	10005
AYDIN CORP	PA	FORT WASHINGTON	19034
BELL INDUSTRIES	CALIF	LOS ANGELES	90067
BERNZOMATIC CORP	N Y	ROCHESTER	14613
BOW VALLEY INDUSTRIES LTD	CANADA	CALGARY	
BRAUN ENGINEERING CO	MICH	DETROIT	48223
BTU ENGINEERING CORP	MASS	NORTH BILLERICA	01862
BUEHLER CORP	IND	INDIANAPOLIS	46236
CALIFORNIA COMPUTER PRODUCTS INC	CALIF	ANAHEIM	92801

EXHIBIT B
Page 2

AUDIT[illegible] NAME - PRICE WATERHOUSE & CO   EXCHANGE - AMEX

COMPANY NAME	STATE	CITY	ZIP
CANADIAN MARCONI CO	QUEBEC	MONTREAL	
CANADIAN MERRILL LTD	CANADA	MONTREAL	
CANADIAN SUPERIOR OIL LTD	ALB	CALGARY	
CARNATION CO	CALIF	LOS ANGELES	90036
CHAMPION HOME BUILDERS CO	MICH	DRYDEN	48428
CHIEFTAIN DEVELOPMENT CO LTD	ALBERT	EDMONTON	
CONNELLY CONTAINERS INC	PA	BALA CYNWYD	19004
CONSYNE CORP	CALIF	SAN MARCOS	92069
COOK INDUSTRIES INC	TENN	MEMPHIS	38116
COURTAULDS LTD	U K	LONDON	
CROWN INDUSTRIES INC	FLA	TAMPA	33609
DANIEL INDUSTRIES INC	TEX	HOUSTON	77055
DIEBOLD VENTURE CAPITAL CORP	N Y	NEW YORK	10022

EXHIBIT B
Page 3

AUDITOR NAME - PRICE WATERHOUSE & CO   EXCHANGE - AMEX

COMPANY NAME	STATE	CITY	ZIP
DREXEL UTILITY SHARES INC	PA	PHILADELPHIA	19101
ELECTRIC HOSE AND RUBBER CO	DEL	WILMINGTON	19899
FABRIC NATIONAL INC	CONN	HARTFORD	06106
FIDELCO GROWTH INVESTORS	PA	ROSEMONT	19010
FILM CORPORATION OF AMERICA	PA	JENKINTOWN	19046
FLIGHTSAFETY INTERNATIONAL INC	N Y	FLUSHING	11371
FLOWERS INDUSTRIES INC	GA	THOMASVILLE	31792
FRANK'S NURSERY SALES INC	MICH	DETROIT	48234
GENERAL HOUSEWARES CORP	CONN	STAMFORD	06901
GLASROCK PRODUCTS INC	GA	ATLANTA	30318
HANOVER PETROLEUM CORP	N Y	NEW YORK	10004
HANOVER SQUARE REALTY INVESTORS	N Y	NEW YORK	10016
HARVEY HUBBELL INC	CONN	ORANGE	06477

EXHIBIT B
Page 4

AUDITO[illegible]ME - PRICE WATERHOUSE & CO — EXCHANGE - AMEX

COMPANY NAME	STATE	PRINCIPAL OFFICE CITY	ZIP
HERFF JONES CO (CARNATION CO)	IND	INDIANAPOLIS	46202
HILLHAVEN INC	WASH	TACOMA	98405
IMPERIAL CHEMICAL INDUSTRIES LTD	U K	LONDON	10015
IMPERIAL OIL LTD	ONT	TORONTO	
INTERNATIONAL SEAWAY TRADING CORP	OHIO	CLEVELAND	44113
INTERWAY CORP	N Y	NEW YORK	10036
IROQUOIS BRANDS LTD	CONN	GREENWICH	06830
IRVIN INDUSTRIES INC	CONN	GREENWICH	06830
JAMESWAY CORP	N J	SECAUCUS	07094
JETRONIC INDUSTRIES INC	PA	PHILADELPHIA	19127
JUPITER INDUSTRIES INC	ILL	CHICAGO	60601
KINGSTIP INC	TEX	AUSTIN	78731
KLEER-VU INDUSTRIES INC	N Y	NEW YORK	10017

EXHIBIT B
Page 5

AUDITOR NAME - PRICE WATERHOUSE & CO EXCHANGE - AMEX

COMPANY NAME	STATE	PRINCIPAL OFFICE CITY	ZIP
LANDMARK LAND COMPANY INC	OKLA	OKLAHOMA CITY	73112
LEATH AND CO	ILL	CHICAGO	60646
MANGOOD CORP	ILL	CHICAGO	60603
METROCARE INC	N J	PARLIN	08859
MICHIGAN SUGAR CO	MICH	SAGINAW	48606
MICKELBERRY CORP	N Y	NEW YORK	10022
MIDWEST RUBBER RECLAIMING CO	ILL	EAST SAINT LOUIS	62202
MILTON ROY CO	FLA	SAINT PETERSBURG	33733
MISSOURI PACIFIC RAILROAD CO	MO	SAINT LOUIS	63103
NATIONAL ALFALFA DEHYDRATING AND MILLING CO	KANS	SHAWNEE MISSION	66201
NEW IDRIA MINING AND CHEMICAL CO	CALIF	SAN FRANCISCO	94104
NEW MEXICO AND ARIZONA LAND CO	ARIZ	PHOENIX	85018
PAN OCEAN OIL CORP	N Y	NEW YORK	10022

EXHIBIT B
Page 6

AUDITOR NAME - PRICE WATERHOUSE & CO — EXCHANGE - AMEX

COMPANY NAME	STATE (PRINCIPAL OFFICE)	CITY (PRINCIPAL OFFICE)	ZIP (PRINCIPAL OFFICE)
PATO CONSOLIDATED GOLD DREDGING LTD	B C	VANCOUVER	
PEPCOM INDUSTRIES INC	N Y	GARDEN CITY	11530
PERMANEER CORP	MO	MARYLAND HEIGHTS	63043
PHOENIX STEEL CORP	DEL	CLAYMONT	19703
PITTSBURGH & WEST VIRGINIA RAILROAD	PA	PITTSBURGH	15222
PITTWAY CORP	ILL	NORTHBROOK	60062
PLACER DEVELOPMENT LTD	B C	VANCOUVER	
PLYMOUTH RUBBER COMPANY INC	MASS	CANTON	02021
RALPH M PARSONS CO	CALIF	PASADENA	91124
REMINGTON ARMS COMPANY INC	CONN	BRIDGEPORT	06602
RESORTS INTERNATIONAL INC	N Y	NEW YORK	10022
RIBLET PRODUCTS CORP	IND	ELKHART	46514
RLC CORP	DEL	WILMINGTON	19803

EXHIBIT B
Page 7

AUDITOR E - PRICE WATERHOUSE & CO EXCHANGE - AMEX

COMPANY NAME	STATE (PRINCIPAL OFFICE)	CITY (PRINCIPAL OFFICE)	ZIP (PRINCIPAL OFFICE)
RONCO TELEPRODUCTS INC	ILL	CHICAGO	60611
ROWLAND PRODUCTS INC	CONN	KENSINGTON	06037
RUSCO INDUSTRIES INC	CALIF	LOS ANGELES	90024
RUST CRAFT GREETING CARDS INC	MASS	DEDHAM	02026
SARGENT INDUSTRIES INC	CALIF	LOS ANGELES	90067
SCURRY-RAINBOW OIL LTD	ALBERT	CALGARY	
SIERRACIN CORP	CALIF	SYLMAR	91342
SOLITRON DEVICES INC	N Y	TAPPAN	10983
SOUNDESIGN CORP	N J	JERSEY CITY	07302
SPECTRO INDUSTRIES INC	PA	JENKINTOWN	19046
STAR SUPERMARKETS INC	N Y	ROCHESTER	14610
SUPERCRETE LTD	MAN	WINNIPEG	
TECH-SYM CORP	TEX	HOUSTON	77027

EXHIBIT B
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AUDITOR [illegible]E - PRICE WATERHOUSE & CO EXCHANGE - AMEX

COMPANY NAME	STATE	PRINCIPAL OFFICE CITY	ZIP
TELEFLEX INC	PA	NORTH WALES	19454
TERRA CHEMICALS INTERNATIONAL INC	IOWA	SIOUX CITY	51101
THE DIVERSEY CORP	ILL	CHICAGO	60603
THE HARTZ MOUNTAIN CORP	N J	HARRISON	07029
THE RATH PACKING CO	IOWA	WATERLOO	50703
THE SUSQUEHANNA CORP	CALIF	LOS ANGELES	90069
TOTAL PETROLEUM (NORTH AMERICA) LTD	MICH	ALMA	
TWIN FAIR INC	N Y	BUFFALO	14043
UNITED NATIONAL CORP	N Y	NEW YORK	10022
VIKING GENERAL CORP	FLA	MIAMI	33138
WASHINGTON POST CO	D C	WASHINGTON	20005
WASHINGTON REAL ESTATE INVESTMENT TRUST	MD	BETHESDA	20014
WOOD INDUSTRIES INC	N J	MIDDLESEX	08846

AUDITOR [illegible]E - PRICE WATERHOUSE & CO

EXCHANGE - AMEX

COMPANY NAME	STATE (PRINCIPAL OFFICE)	CITY (PRINCIPAL OFFICE)	ZIP (PRINCIPAL OFFICE)
WORK WEAR CORP	OHIO	CLEVELAND	44114

***** TOTALS - 105 COMPANIES

EXHIBIT C
Page 1

FEDERAL, STATE AND LOCAL GOVERNMENT CLIENTS

FOR WHICH SERVICES WERE RENDERED IN 1975

911 - Federal government

Amtrak
Armed Forces Relief and Pension Fund
Comptroller of the Currency
Contract Appeals Board - U.S. Navy
Council on International Economic Policy
Department of Commerce
Department of Health, Education and Welfare
Dept of the Interior
Dept of Justice
Dept of State
Export Import Bank
Farm Credit Administration
Federal Aviation Administration
Federal Communications Commission
Federal Energy Office Administration
General Accounting Office
Legal Services Corp
National Service Foundation
Pension Benefit Guaranty Corporation
OPIC Overseas Private Investment Corp
Small Business Administration
U.S. Postal Service - Philatelic
U.S. Railway Assoc
U.S. Information Agency

921 - State government

Commonwealth of Massachusetts - Treasury Dept
State of Illinois Arts Council - Chicago
State of Illinois - Treasurer's Office
State of Ohio - Dept of Education
Connecticut Dept of Transportation
Connecticut Housing Finance Authority
Connecticut Dept of Education
Commecticut Commission for Higher Education
State of Florida - Division of Aging
State of Nebraska - Dept of Admin
Wisconsin Dept of Administration
New Jersey Economic Development Authority
New York State - Dept of Mental Hygiene
Delaware Attorney General's Office
Penna State Legislative Audit Advisory Committee
Penna State Board of Law Examiners
Penna Dept of Community Affairs
Penna State Court Administrator
Providence, Rhode Island - Howard Development Corporation
California Hospital Commission
California - Sacramento Selection Consulting Center
Alaska Division of Medical Assistance
Missouri Public Sevice Commission
State of Missouri - Auditor's Office

EXHIBIT C
Page 2

921 - State government (continued)

Commonwealth of Puerto Rico - Economic Development Admin
Montana State Auditor's Office
State of Washington - Ferries and Toll Board
State of Washington - Liquor Control Board
State of Illinois - Controller's Office
New York State - Dept of Budget
Penna Dept of Affairs
New Jersey Division of Medical Assistance
Washington - Dept of Ecology

931 - Local government

City of Juneau, Alaska
City of Soldotna, Alaska
City of Battle Creek, Michigan
Battle Creek, Michigan - Area Metropolitan Services Agency
Battle Creek Transit Authority
City of Paterson, New Jersey
Boston, Mass. - Auditor's Dept
Boston, Mass. - School Committee
Town of Brookline, Mass.
Town of Reading, Mass.
City of Asheville, N. Carolina
Cumberland County, N. Carolina
Northern Illinois - Regional Transit Authority
Village of Carol Stream, Illinois
Village of Glen Ellyn, Illinois
City of Weschester - Park District
City of Cincinnati, Ohio
Transit Authority of Northern Kentucky - Newport, Kentucky
Cleveland, Ohio - City Council
Columbus, Ohio - Board of Education
Mid-Ohio Regional Planning Commission, Columbus
City of Dallas, Texas
City of Cedar Hill, Texas
City of Gross Point Woods, Michigan
City of Hallandale, Florida
Harris County, Texas - Treasurer's Office
Suffolk County, New York - Water Authority
Village of Kings Point, Long Island
Village of Rockville Centre, Long Island
Los Angeles, California - Water Revenue Fund
San Bernardino, California - Municipal Water Dept
City of Memphis, Tenn
City of Homestead, Florida
Metropolitan Dade County, Florida - Aviation
South Florida Regional Planning Council, Miami
Milwaukee County, Wisconsin - District Attorney's Office
Milwaukee County, Wisconsin - Hospital & Mental Instititions
Outagamie County, Wisconsin - Health Center
Rock County, Illinois - Health Care Center

EXHIBIT C
Page 3

931 - Local government (continued)

City of Brentwood, Tennessee
Nashville, Tennessee - First Suburban Water Utility District
New York City Transit Authority
City of Ocala, Florida
City of Peoria, Illinois - Dept of Public Works
Greater Peoria, Illinois - Sanitation and Sewage Disposal Dist
Bucks County, Penna - Office of Manpower Programs
City of Englewood, New Jersey
Philadelphia, Penna - City Controller
City of Glendale, Arizona
Fox Chapel Borough, Penna
Sewickley Borough, Penna
City of Portland,Oregon
City of Vancouver, Washington
Lincoln County, Oregon - School District
Washington County, Oregon
City of Rocky Mount, N. Carolina
City of Raleigh, N. Carolina
County of Monroe, New York
Rochester-Genesee, New York - Regional Transporation Authority
City of St. Louis, Missouri - Water Division
City of Wellston, Missouri
St. Louis County, Missouri - County Police
City of San Diego, California
Coachella Valley, California - County Water District
San Diego, California - Comprehensive Planning Organization
California Toll Bridge Authority
Municipality of San Juan, Puerto Rico
City of Gardena, California
Orange County, California - Transit District
Orange County, California - Civic Center Authority
Orange County, California - Revenue Sharing Fund
City of Santa Fe Springs, California
King County, Washington - Systems Services Dept
Municipality of Metropolitan Seattle, Washington
Seattle, Washington - Civil Service
City of Seattle, Washington
King County, Washington - Water District #75
County of Delaware, New York - Dept of Social Services
Onondaga County, New York - Water Authority
City of Clearwater, Florida
City-County Water Agreement - Toledo, Ohio
Montogmery County, Maryland - Landlord-Tenants Baord

EXHIBIT C
Page 4

932 - Local authority for toll roads, bridges, tunnels, etc.

Jersey City, New Jersey - Housing Authority
City of Boston - Educational Facilities Authority
Chicago, Illinois - Metropolitan Fair and Exposition Authority
Port of New York Authority, New York City
Aliquippa, Penna - Municipal Water
Bellevue, Penna - School Authority
Borough of Alquippa, Penna - Sewer System Fund
Center Township, Penna - Sewer Authority
Chartiers Valley, Penna - District Flood Control
Fox Chapel, Penna - Sanitary Authority
Sewickley Area, Penna - School Authority
Sewickley Township, Penna - School Authority
Washington-East Washington, Penna - Joint Water & Sewage Authority
Portland, Oregon - Metropolitna Area 4C Council
Monroe County, New York - Water Authority
St. Louis, Missouri - Tower Grove Park
State of Washington - Urban Arterial Board
Toledo, Ohio - Metropolitan Housing Authority

821 - Goverment operated schools

Cambridge, Mass. - School Dept
Dallas, Texas - Independent School District
St. Marks School of Texas - Dallas
Denver, Colorado - Public School District
Jefferson County, Colorado - School District
L'anse Creuse, Michigan - Board of Education
Indianapolis, Indiana - Public Schools
Berkeley, California - Unified School District
Upper Darby, Penna - School District
North Clackamas, Oregon - School District
Brentwood, Missouri - School District
Jennings, Missouri - School District
Grossmont, California - Union High School
Fremont, California - Unified School District
Santa Clara, California - Unified School District

EXHIBIT D

SERVICES PERFORMED BY PW FOR FEDERAL GOVERNMENT
DURING THE YEARS JUNE 30, 1970 THROUGH JUNE 30, 1975

	(YEARS ENDED JUNE 30)					
	1975	1974	1973	1972	1971	1970
Amtrak	X					
Armed Forces Relief and Pension Fund	X					
Comptroller of the Currency	X	X	X	X	X	
Contract Appeals Board - U.S. Navy	X					
Council on International Economic Policy	X					
Department of Commerce	X	X	X	X		
Dept. of Health, Education & Welfare		X				
Dept. of Housing & Urban Development				X	X	
Dept. of the Interior	X	X				
Dept. of Justice	X	X				
Dept. of Labor				X		
Dept. of State	X					
Economic Development Administration						X
Environmental Protection Agency			X			
Export Import Bank		X	X			
Farm Credit Administration	X					
Federal Aviation Administration	X					
Federal Communications Commission	X					
Federal Energy Office Administration	X	X				
General Accounting Office	X					
Internal Revenue Service		X	X			
Legal Services Corp.	X					
National Service Foundation	X					
Pension Benefit Guaranty Corporation	X					
OPIC Overseas Private Investment Corp.	X					
Small Business Administration	X					
Treasury Department			X			
U.S. Postal Service - Philatelic	X					
U.S. Railway Assoc.	X					
U.S. Information Agency	X					

67-159 O - 77 - 26

TOUCHE ROSS & CO.
1633 BROADWAY
NEW YORK, NEW YORK 10019

RUSSELL E. PALMER
Managing Partner

February 20, 1976

Honorable Lee Metcalf
United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

I am pleased to forward the information requested in your letter of December 19, 1975. Answers are sequenced in the same order as were the questions. Explanatory notes are included whenever numeric data may not respond precisely to the question asked.

This information is submitted by Touche Ross solely for the information of your Committee and its staff. Nearly all of the enclosed data is proprietary, is developed for our internal use, and is not made available to the accounting profession or the public. We trust you understand our interest in controlling its distribution.

I trust the enclosed statements will satisfy the requirements of the Subcommittee on Reports, Accounting and Management.

Very truly yours,

Russell E Palmer

REP/jr

TOUCHE ROSS & CO.

Replies to Questionnaire of Reports, Accounting and Management Subcommittee (as of December 31, 1975).

1. 76

2. 37

3. 235

4. 451

5. 33

6. 4,219

7.

A.	Auditing and Accounting	62.2%
B.	Tax services	23.5
C.	Management services	14.3
		100.0%

D. None. However, actuarial services are made available through a joint venture arrangement with Touche Ross Stennes.

E. CONFIDENTIAL BY TOUCHE ROSS & COMPANY REQUEST

F. None

8.

A. Yes, on a modest scale. For the most part these services are an adjunct to those normally provided audit, tax and management services clients.

B. Yes

C. Yes

D. Yes

E. No. See 7 D. above

Touche Ross & Co.
Page Two

F. Only on a voluntary basis at no expense to the government. At present, Mr. D.V. Burchfield, a partner, is serving on the General Services Administration Advisory Committee on Cash Management.

9. Separate listing attached

10. Separate listing attached

11. Other publicly-held corporations for which Touche Ross & Co. is the independent auditor - 380.

Privately-held corporations for which Touche Ross & Co. is the independent auditor - 1,516.

12.

Partners	442
Principals	0
Employees	1,016

13. Yes, as follows:

1973	$200,000
1974	200,000
1975	200,000

14. Separate listing attached

15. Separate listing attached

16. Fiscal Year Ended August 31,

1970

1971

1972

1973

1974

1975

CONFIDENTIAL BY
TOUCHE ROSS & COMPANY
REQUEST

17. No.

Touche Ross & Co.
Question #9

Corporations listed on the New York Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
ALBERTSONS INC.	P.O. Box 20, Boise, Id. 83701
ALEXANDERS INC.	3rd Ave. & 152nd St., Bronx, N.Y.
ALLIED STORES CORP	401 5th Ave., N.Y.,N.Y.10016
AMERICAN HOIST & DERRICK	63 Robert St., St. Paul, Mn. 55101
AMERICAN HOSPITAL SUPPLY	1740 Ridge Ave., Evanston, Il. 60201
AMERICAN MOTORS CORP	14250 Plymouth Rd. Detroit, Mi. 48232
APL CORP	557 Wortman, Brooklyn, N.Y. N.Y. 11208
ARKANSAS LOUISIANA GAS CO	Slattery Bldg., Shreveport, La. 71101
ARMOUR AND COMPANY	401 N. Wabash Ave., Chicago, Il. 50509
ASSOCIATED DRY GOODS CORP	417 5th Ave., N.Y.,N.Y. 10016
AUTOMATIC DATA PROCESSING	405 Rte 3, Clifton, N.J. 07015
BLAIR JOHN & COMPANY	717 5th Ave., N.Y,N.Y.10020
BLOCK H & R INC	4410 Main St., Kansas City, Mo. 64111
BOEING COMPANY THE	P.O. Box 3707, Seattle, Wa. 98124
BUCYRLS-ERIE CO	So. Milwaukee, Wi.53172
BURNDY CORP	Richard Ave., Norwalk, Ct. 06850

Corporations listed on the New York Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
C.I.T. FINANCIAL CORPORAT	650 Madison Ave., N.Y., N.Y. 10022
CALIFORNIA FINANCIAL CORP	285 S. 1st St., San Jose,Ca.
CASCADE NATURAL GAS CORP	222 Fairview Ave.,N., Seattle, Wa. 98109
CHELSEA INDUSTRIES INC.	181 Spencer Ave., Chelsea, Ma. 02150
CHRYSLER CORP	841 Massachusetts Ave., Detroit, Mi. 48231
CITIZENS MTGE INVESTMENT	600 Woodward, Detroit,Mi.48226
COASTAL STATES GAS CORP	P.O.Box 521, Petroleum Tower, Corpus Christi, Tx.
COMPUTER SCIENCES CORPORA	650 N. Sepulveda Blvd., El Segundo, Ca. 90245
DESOTO INC	1700 S. Mt. Prospect Rd., Des Plaines, Il. 60016
ELGIN NATIONAL IND	366 Bluff City Blvd., Elgin, Il., 60120
EVANS PRODUCTS COMPANY	P.O.Box 3295, Portland, Or.97208
FAIRCHILD INDUSTRIES INC	Sherman Fairchild Tech. Cen. Germantown, Md. 20967
FEDERATED DEPARTMENT STOR	222 W. 7th St., Cincinnati, Oh.45202
FIRST CHARTER FINANCIAL C	9465 Wilshire Blvd., Beverly Hills, Ca. 90212

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Corporations listed on the New York Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
FLEMING CO INC	Garlinghouse Bldg., Topeka, Ka. 66612
FOXBORO CO THE	38 Neponset Ave., Foxboro, Ma. 02035
FRUEHAUF CORP	10940 Harper Ave., Detroit, Mi. 48232
GOLDEN WEST FINANCIAL COR	1632 Franklin St., Oakland, Ca.
GREYHOUND CORPORATION	10 S. Riverside Pl., Chicago, Il. 60606
IDS PROPERTIES, INC.	1050 Roanoke Bldg., Minneapolis, Mn. 55402
INTERSTATE STORES	111 8th Ave., N.Y.,N.Y. 10011
IOWA BEEF PROCESSORS INC	Dakota City, Ne. 68731
JEWEL COMPANIES INC	1955 W. North Ave., Melrose Pk., Il. 60160
JUSTICE MORTGAGE INVESTOR	1400 Main St., Dallas, Tx. 75202
KAISER CEMENT & GYPSUM CO	300 Lakeside Dr., Oakland, Ca. 94612
KELLWOOD CO	9909 Clayton Rd., St. Louis, Mo. 63124
LARWIN MULTIHOUSING CORP	9100 Wilshire Blvd., Beverly Hills, Ca. 90212
LENOX INCORPORATED	Prince & Meade Sts., Trenton, N.J. 08605
LIBBY MC NEILL & LIBBY	200 So. Michigan Ave., Chicago, Il. 60604

Corporations listed on the New York Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
LITTON INDUSTRIES INC	9370 Santa Monica Blvd., Beverly Hills, Ca. 90210
MACY R H & CO INC	151 W. 34th St., N.Y.,N.Y. 10001
MEAD CORP	Talbott Tower, Clayton, Oh.45402
MEDICAL COMPUTER SYSTEMS, INC	1625 W. Mockingbird Ln., Dallas, Tx. 75235
MICHIGAN WHEEL CORP	1501 Buchanan,S.W.,Grand Rapids, Mi. 49502
MUNFORD INC	68 Brookwood Dr.,N.E., Atlanta, Ga. 30309
NATIONAL CAN CORP	5959 Cicero Ave., Chicago, Il. 60638
NATIONAL CITY LINES INC	700 Security Life Bldg.,Denver, Co. 80202
NATIONAL DETROIT CORP	611 Woodward Ave., Detroit, Mi. 48226
NATIONAL INDUSTRIES INC	510 W. Broadway, Louisville, Ky. 40202
NORTH CAROLINA UTILITY	Atlanta, Ga.
NUCOR CORP	4425 Randolph Rd., Charlotte, N.C. 28211
OXFORD INDUSTRIES INC	222 Piedmont Ave., N.E., Atlanta, Ga. 30312
PAMIDA INC	8800 "F" St., Omaha, Ne.
PILLSBURY CO	600 Pillsbury Bldg, Minneapolis,Mn.

Corporations listed on the New York Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
R T E CORP	1900 E. North St., Waukesha, Wi. 53186
RELIANCE GROUP INC	17 Barston Rd., Great Neck, N.Y. 11021
ROHR INDUSTRIES	Foot of H St., Chula Vista, Ca. 92010
RONSON CORP	1 Ronson Rd.,Woodbridge,N.J.07095
ROPER CORP	1905 W. Court St., Kankakee, Il. 60901
SAFEGUARD INDUSTRIES INC	1616 Walnut St., Philadelphia, Pa. 19103
SALANT CORP	330 5th Ave.,N.Y.,N.Y. 10001
SAV-ON-DRUGS INC	3856 W. Santa Barbara Ave., Los Angeles, Ca.
SEARS ROEBUCK AND CO	925 S. Homan Ave,Chicago,Il. 60607
SKIL CORP	5033 Elston Ave, Chicago,Il. 60630
SOLA BASIC INDUSTRIES INC	P.O.Box 753, Milwaukee, Wi. 53201
SOS CONSOLIDATED INC	1411 N. Woodward Ave., Birmingham, Mi. 48011
SQUARE D CO	Executive Plaza, Dark Ridge Il. 60068
ST. PAUL SECURITIES INC	385 Washington St., St. Paul, Mi. 55102
STARRETT, LS COMPANY THE	121 Crescent St, Athol, Ma.01331

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Corporations listed on the New York Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
SUPER VALUE STORES INC	101 Jefferson Ave, Hopkins, Mi. 55343
SUPERMARKETS GENERAL CORP	116 Main Ave., Passaic,N.J.07055
TECKLA INC	Bank of Southwest Bldg., Amarillo, Tx. 79109
TESORO PETROLEUM	8520 Crown Hill Blvd., San Antonio, Tx.
TEXAS OIL & GAS CORP.	2520 Fidelity Union Tower, Dallas, Tx. 75201
TRANS-WORLD FIN CO	9601 Wilshire Blvd., Beverly Hills, Ca. 90210
TSC INDUSTRIES	4747 N. Ravenswood Ave, Chicago,Il.
UNISHOPS INC	21 Caven Point Ave., Jersey City, N.J. 07305
VENICE INDUSTRIES INC	1407 Broadway, N.Y.,N.Y.
VESTAUR SECURITIES INC	1411 Walnut St., Philadelphia, Pa. 19102
WELBILT CORPORATION	Welbilt Square, Maspeth,N.Y.11378
WESTLAND CAPITAL CORP	2021 Hennepin Ave., Minneapolis, Mi. 55413
WYOMING BANCORPORATION	Cheyenne,Natl. Bank Tower Bldg., Cheyenne, Wy. 82001
ZALE CORP	Box 2219, Dallas, Tx. 75221

Touche Ross & Co.
Question #10

Corporations listed on the American Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
AERONCA INC	1712 Germantown Rd., Middletown, Oh. 45042
AIRBORNE FREIGHT CORP	Coleman Bldg.,Seattle,Wa.98104
AMERICAN PRECISION INDUST	2777 Walden Ave.,Buffalo, N.Y. 14225
AQUITANE CO CANADA LTD	1300 Calgary House, 550 6th Ave.,S.W., Clagary,Alberta, Canada
ARUNDEL CORPORATION	501 St. Paul Pl.,Baltimore, Md. 21202
BARCLAY INDUSTRIES INC	65 Industrial Rd.,Lodi,N.J.07644
BARCO OF CALIFORNIA	350 W. Rosecrans Ave., Gardena, Ca. 90248
BARNWELL INDUSTRIES INC	Henry C. Beck Bldg., Shreveport, La. 71101
BERG ENTERPRISES, INC.	12 Center St.,Metuchin, N.J.
BIG V SUPERMARKETS	176 N. Main St.,Florida,N.Y.10921
BLESSINGS CORP	146 Madison Ave.,N.Y.,N.Y.10016
BOMAINE CORP	2121 S.Bundy Dr.,Los Angeles, Ca. 90064
BRANCH INDUSTRIES, INC	146 Madison Ave.,N.Y.,N.Y.10016
BUTLER CREATION INT'L	
BUTTES GAS & OIL CO	2150 Franklin St., Oakland, Ca. 94612
C H B FOODS INC	7351 Crider Ave., Pico Rivera,Ca.
C R S DESIGN ASSOCIATES I	111 W.Loop,S. Houston, Tx.77027

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Corporations listed on the American Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
CERTRON CORPORATION	1701 S. State College Blvd., Anaheim, Ca.
CHADWICK-MILLER INC	690 Dudley St.,Boston, Ma.
CHRISTIANA COMPANIES, INC	3025 Olympic Blvd.,Santa Monica, Ca. 90404
CITY GAS CO OF FLORIDA	955 E.25th St.,Hialeah,Fl.33013
CLOPAY CORPORATION	Clopay Square,Cincinnati,Oh.45214
COMMERCIAL METAL CO	512 S.Arkard St.,Dallas,Tx.75221
COMPAC CORP	420 Frelinghuyser Ave, Newark, N.J. 07114
COMPO INDUSTRIES INC	125 Roberts Rd.,Waltham,Ma.02154
COTT CORP	177 Granite St., Manchester, N.H. 03101
CREST-FOAM CORP	100 Carol Pl.,Moonachie, N.J.
DELTOWN FOODS INC	170 Sawmill River Rd., Yonkers, N.Y. 10702
DIXILYN CORP	P.O.Box 3427 Odessa,Tx. 79760
EDWARDS A G & SONS INC	1 N.Jefferson Ave.,St.Louis, Mo.63103
EVANS-ARISTOCRAT INDUSTRI	400 Trumbell St., Elizabeth, N.J. 07206
FINANCIAL CORP SANTA BARB	11 W.Figueroa St., Santa Barbara, Ca. 93102
FRIGITRONICS INC	770 River Rd.,Shelton,Cn.06484

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Corporations listed on the American Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
GARLAND CORP	Garland Plaza,Brockton,Ma.02401
GAYNOR-STAFFORD INDUSTRIES	1450 Broadway, N.Y.,N.Y.10018
GOOD L S & CO	1141 Market St.,Wheeling,W.Va.
GORIN STORES INC	1019 Commonwealth Ave., Boston, Ma. 02106
GRUEN INDUSTRIES INC	20 W.47th St.,N.Y.,N.Y.10036
HAMPTON INDUSTRIES	501 E. Caswell St., Kinston, N.C.28501
HEALTH INDUSTRIES	39 Exchange Pl.,Salt Lake City,Ut
HEITMAN MORTGAGE INVESTOR	10 S.LaSalle St., Chicago, Il. 60603
HOUSTON OIL & MINERALS CO	242 The Main Bldg.,Houston, Tx. 77002
HOWELL INDUSTRIES INC	12340 Cloverdale Ave., Detroit, Mi. 48204
ICB CORP THE	New Orleans, La.
JACLYN INC	635 59th St., W.N.Y.,N.J.
JUNIPER PETROLEUM CORP	1600 Grant St.,Capital Life Cen., Denver, Co.
KAISER INDUSTRIES CORP	Kaiser Center, 300 Lakeside Dr., Oakland,Ca. 94604
KUHN'S-BIG K STORES CORP	3040 Sidco Dr.,Nashville, Tn. 37204
LLOYDS ELECTRONICS INC	18601 S. Susana Rd., Compton, Ca. 90221

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Corporations listed on the American Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
LOEHMANNS INC	9 W.Fordham Rd.,Bronx,N.Y.10468
LOGISTICS INDUSTRIES CORP	400 Nepperham Ave., Yonkers, N.Y. 10701
MASONEILAN INTERNATIONAL	63 Nahatan St., Norwood,Ma.02062
MDC CORP	26 Springdale Rd., Cherry Hill, N.J. 08003
MEDCO JEWELRY CORP	1211 Walnut St., Kansas City, Mo. 64106
NATIONAL SYSTEMS CORP	4401 Birch St., Newport Beach, Ca. 92660
NOVO INDUSTRIAL CORP	219 E.42nd St.,N.Y.,N.Y.10017
OZARK AIR LINES INC	Lambert St., St. Louis Municipal Airport, St.Louis, Mo.63145
PARK ELECTROCHEMICAL CORP	84-10 Linden Pl., Flushing, N.Y. 11354
PATRICK PETROLEUM CO	744 W. Michigan Ave., Jackson, Mi.49201
PHILADELPHIA MORTGAGE TRU	215 S. Broad St., Philadelphia, Pa. 19107
POLORON PRODUCTS OF LOUIS	165 Huguenot St.,New Rochelle, N.Y. 10801
READING INDUSTRIES INC	350 5th Ave.,N.Y.,N.Y.
RESTAURANT ASSOC IND INC	1540 Broadway, N.Y.,N.Y.
SAMBOS RESTAURANTS INC	3760 State St., Santa Barbara, Ca. 93105

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Corporations listed on the American Stock Exchange for which Touche Ross & Co. is the independent auditor

NAME	ADDRESS
SCHICK INCORPORATED	Webster Rd.,Milford,Cn.06460
SEA CONTAINERS INC	345 Park Ave.,N.Y.,N.Y.10022
SEASON-ALL INDUSTRIES INC	Rte 119 S.,Indiana, Pa. 15701
SHENANDOAH CORP	P.O.Box 551, Charles Town, W.Va. 25414
SHOPWELL INC	400 Walnut Ave.,Bronx,N.Y.10454
SUNCRAFT DIV ABERDEEN MFG	95 Santa Fe Ave.,Fresno,Ca.93721
SUPERIOR SURGICAL MFG CO	63 New York Ave.,Huntington, N.Y. 11743
SYSCO CORPORATION	800 Capital Nat'l.Bank Bldg., 1300 Main St. Houston,Tx. 77002
TOWN & COUNTRY MOBILE HOM	1st Wichita Nat'l.Bank Bldg. Wichita Falls, Tx.
TURBODYNE CORP	800 Central Ave., Minneapolis,Mn.
UNIVERSAL CONTAINER CORP	104 S. Central Ave., Valley Stream, N.Y. 11580
UNIVERSAL-RUNDLE CORP	P.O. Box 960,New Castle,Pa.16103
VALLEY INDUSTRIES INC	c/oFederated Purchaser Inc, 475 5th Ave., N.Y.,N.Y.
VULCAN INC	Ave. E, Latrobe, Pa. 15950

14. Listing of departments, agencies or subdivisions of federal, state, municipal or other government authority for which Touche Ross & Co. performed any services during 1975.

FEDERAL

Board of Governors, Federal Reserve System
Executive Office of the President
Federal Communications Commission
Federal Energy Administration
Federal Home Loan Bank Board
HEW, Department of Medicaid
HEW, Social and Rehabilitation Service
Labor, Department of
National Commission on Water Quality
National Corporation for Housing Partnerships
National Institute on Drug Abuse
National Institute of Education
Office of the Assistant Secretary of Defense/Health & Environment
Special Action Office for Drug Abuse Prevention
Transportation, Department of
U.S. Department of the Army

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STATE

Alaska/Health & Social Services Department
Arkansas/HEW
Arkansas/Public Service Commission
California/Highway Patrol Department
California/Veterans, Department of
Colorado/Revenue Department
Colorado/River Commission
Delaware/Labor Department
Delaware/River and Bay Authority
District of Columbia
Florida/INTERAMA
Florida/Parole and Probation
Georgia/Attorney General
Georgia/Corrections Department
Hawaii/Housing Authority
Hawaii/International Sport
Idaho/Auditor
Idaho/Health & Welfare Department
Idaho/Highway Department
Idaho/Treasurer
Illinois/Correction Department
Illinois/Health Facilities Authority
Illinois/Housing Authority
Indiana/Governors Task Force
Indiana/State Police
Indiana/Title XX
Indiana/Welfare, Department of
Iowa/Power & Light
Kansas/Corrections Department
Kansas/Social
Kentucky/Finance Department
Kentucky/Human Resources Department
Kentucky/Public Service Commission
Massachusetts/Advisory Council on Vocational Technical Education
Massachusetts/Defense Committee
Massachusetts/Executive Office of Manpower Affairs
Michigan/Commerce, Department of
Michigan/Highway
Michigan/Office of Substance Drug Abuse
Michigan/Public Service Commission
Michigan/Senate Tax Committee
Michigan/Social Services Department
Minnesota/Employment Services Department
Minnesota/Public Service Commission
Mississippi/Public Service Commission
Missouri/Council on Criminal Justice
Missouri/Law Enforcement Council
Missouri/State Auditor
Montana/Medicaid
Nebraska/Corrections Department
Nebraska/Welfare Department
Nevada/Public Service Commission

New Hampshire/Public Service Commission
New Jersey/Labor & Industries Department
New Jersey/Public Advocate
New York/Board of Education
New York/Moreland Commission
North Carolina/Public Service Commission
Ohio/Public Service Commission
Oklahoma/City Housing
Oregon/Human Resources
Pennsylvania/Turnpike
Rhode Island/Education Department
South Carolina/Probation Department
Tennessee/Public Health Department
Texas/Attorney General
Texas/Board of Pardons & Paroles
Texas/Corrections Department
Vermont/Public Service Commission
Virginia/Health Department
Virginia/Welfare Department
Washington/Board for Community College Education
Wyoming/Health and Social Services
Wyoming/Manpower
Wyoming/Public Service Commission

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LOCAL	TOUCHE ROSS & CO. OFFICE
Alameda County, California/WAT	San Francisco
Albany	Portland
Allegheny County, Pennsylvania/CETA	Pittsburgh/Philadelphia
Allegheny County Ind. Dev.	Pittsburgh
Anchorage, Alaska, Greater Borough of	Seattle
Atlanta, Georgia/Attorney General	Atlanta
Atlanta, Georgia/Vehicle Maintenance Division	Atlanta
Atlanta, Georgia/Housing Authority	Atlanta
Atlantic City, New Jersey	Philadelphia
Atlantic County, New Jersey	Philadelphia
Bellevue, City of	Cincinnati
Bensalem Twp., Pennsylvania	Philadelphia
Board of Coop Education	Rochester
Boston, Massachusetts/Police Dept.	Boston
Caledonia Board of Education	Grand Rapids
Cape May Point Bor., New Jersey	Philadelphia
Carson City	Grand Rapids
Chapel Hills, Colorado/Water	Denver
Cherokee Water District, Colorado	Denver
Chesapeake, Virginia	Atlanta/Washington
Chicago, Illinois/Mayors Office of Manpower	Chicago
Cimarron, Colorado/Sanitation	Denver
City School District	Rochester
Clermont City San.	Cincinnati
Cleveland, Ohio	Cleveland
C M Co. Bridge Comm.	Philadelphia
Community Action Program	Grand Rapids
Cook County, Illinois/Clerk of Circuit Court	Chicago
Coopersville Board of Education	Grand Rapids
Corpus Christi, Texas	Houston
County Counselor	St. Louis
Cranford Twp.	Newark
Criminal Justice Inst.	Detroit
Cumberland County	Philadelphia
Cupertino Union School	San Francisco
Dade County, Florida/Water & Sewer Bd.	Dallas
Dallas, Texas/County Mental Health & Retardation	Dallas
Darby Borough, Pennsylvania	Philadelphia
Dayton, Ohio/Metro Housing	Dayton
Dennis Twp.	Philadelphia
Denver, Colorado/County Courts	Denver
Denver, Colorado/HEW	Denver
Denver, Colorado/Housing Authority	Denver
Denver, Colorado/Water Dept.	Denver
Detroit, Michigan/House of Correction	Detroit
Detroit, Michigan/Model Neighborhood	Detroit
Detroit, Michigan/Police Dept.	Detroit
Donala Water and Sanitation	Denver
Dorchester, Massachusetts/Courts	Detroit
Dover, Delaware	New York
Dupage County, Illinois	Chicago
Durall Co. Water Dis.	Houston

LOCAL (cont'd)	TOUCHE ROSS & CO. OFFICE
East Orange, New Jersey	Newark
Family Service	Detroit
Federation of Rock	Denver
Fennville, City of	Grand Rapids
Florham Park Sewer	Newark
Fond du Lac, Wisconsin	Milwaukee
Forest Hills City	Nashville
Franklin - McKinley	San Francisco
Fresno Metro Flood	Fresno
Fulton County, Georgia/Tax Assessors Office	Atlanta
Garden State Water	New York
Garland, Texas	Dallas
Grand Rapids, Michigan	Detroit
Grand Harbor/Board of Education	Grand Rapids
Greenville, South Carolina	Atlanta
Hammonton, New Jersey	Philadelphia
Hartford, Connecticut	Boston
Hialeah, Florida/Housing Authority	Miami
Houston, Texas	Houston
Human Development Corp.	St. Louis
Independence, Missouri	Kansas City
Ionia, Michigan	Grand Rapids
Jacksonville, Florida	Atlanta
Jefferson County, Kentucky	Louisville
Jersey City, New Jersey/Board	Newark
Kansas City, Missouri/Corrections Dept.	Detroit
Kent County, Michigan	Grand Rapids
Kentwood, Michigan/Board of Education	Grand Rapids
King County, Washington/Court House	Seattle
Land Reutilization Authority	St. Louis
Lansing, Michigan/Social Welfare	Detroit
Los Angeles, California/Emergency Medical Service	Los Angeles
Louisville, Kentucky/Riverfront Corp.	Louisville
Lower Twp., Philadelphia, Pennsylvania	Philadelphia
Lower Twp., Philadelphia, Penn./Board of Educ.	Philadelphia
Marion County, Oregon	Portland
Miami, Florida/Chamber of Commerce	Miami
Miami, Florida/Postal Service	Miami
Middlesboro, Kentucky	Louisville
Minneapolis, Minnesota/Human Resources Dept.	Minneapolis
Miramar, Florida	Atlanta
Missouri Law Enforcement Agency	St. Louis
Model Cities	Cincinnati
Model Cities	Grand Rapids
Model Neighborhood	Detroit
Monmouth County	Newark
Montclair Redevelopment	Newark
Montgomery Public	Washington
Morristown, New Jersey/Water Dept.	Newark
Newark, New Jersey/Board of Education	Newark
Newark, New Jersey/Director of Manpower	Newark
New Castle County, Pennsylvania	Philadelphia

LOCAL (cont'd)	TOUCHE ROSS & CO. OFFICE
New Haven, Connecticut/Police	Boston
New Jersey/Dept. of Labor & In.	Newark
New York Model Cities	New York
New York, New York/Board of Education	New York
Nolan County-City of Sweetwater, Texas/Hospital Bd.	Atlanta
Norcen Housing Con.	Pittsburgh
North Kansas City School, Missouri	Kansas City
Northwest Regional Council	Seattle
North Wildwood, New Jersey	Philadelphia
Nueces Co., Texas/Water Dis.	Houston
Oak Park, City of	Detroit
Ocean City, Philadelphia	Philadelphia
Ocean City, Philadelphia/Board of Education	Philadelphia
Oshkosh Schools, Wisconsin	Milwaukee
Paterson, New Jersey	Newark
P. G. County Government	Washington
Philadelphia, Pennsylvania/Office of Controller	Philadelphia
Phoenix, Arizona	Phoenix
Pittsburgh, Pennsylvania/Model Cities	Pittsburgh
Polk County, Oregon	Portland
Pontiac, Michigan/Public Works Dept.	Detroit
Pontiac, Michigan/Stadium Authority	Detroit
Port Huron, Michigan	Detroit
Port of Port Angeles, Washington	Seattle
Port of Portland, Oregon	Portland
Port of San Francisco, California	San Francisco
Port of Seattle, Washington	Seattle
Poway Unified School District, California	San Diego
Project Search	Chicago
Regional Justice Institute	St. Louis
Rochester, New York/City Engineer	St. Louis
Rockland County, New York	New York
Rome, Georgia	Atlanta
Royal Oak, Michigan	Detroit
Sacramento, California	San Francisco
Salem, Oregon/Housing Authority	Portland
Salem, Oregon/Sewer and Dr.	Portland
San Antonio, Texas/Housing Authority	Houston
San Francisco, California/Adult Probation	San Francisco
San Francisco Airport Commission	San Francisco
San Francisco, California/Golden Gate Bridge	San Francisco
San Francisco, California Redevelopment	San Francisco
San Mateo, California	San Francisco
Santa Clara County, California	San Francisco
Santa Monica, California	Los Angeles
Scheboygan, Wisconsin	Milwaukee
School Dist. 11 - Elem., Wisconsin	Milwaukee
Scotch Plains Twp., New Jersey	Newark
Scottsdale, Arizona	Phoenix
Seattle, Washington/Community Development	Seattle
Seattle, Washington/Controllers Office	Seattle
Seattle, Washington/General Services Dept.	Seattle

LOCAL (cont'd)	TOUCHE ROSS & CO. OFFICE
Seattle, King County, Washington/Health Dept.	Seattle
Seattle, Washington/Management & Budget Office	Seattle
Seattle, Washington/METRO	Seattle
S.E. Michigan Trans. Authority	Detroit
Somers Point, New Jersey	Philadelphia
South Central Criminal Justice Region, Conn.	Boston
Sparta, Michigan/Board of Education	Grand Rapids
St. Louis, Missouri/Police Dept.	St. Louis
Stanislaus County, California	San Francisco
Stone Harbor, New Jersey	Philadelphia
Suffolk County, New York/Social Services Dept.	New York
Sweetwater, Texas/Water District	Dallas
Tacoma, Washington/Equipment Rental Division	Seattle
Tillanook County, Oregon	Portland
Township of Alpine, Michigan	Grand Rapids
Township of Tallina, Michigan	Grand Rapids
Tulsa, Oklahoma/Housing Authority	Kansas City
Turlock Irrigation District, California	San Francisco
Tyler, Texas	Dallas
Urban West Housing Corp.	St. Louis
Virginia Beach, Virginia/Health Dept.	Detroit
Waco, Texas	Dallas
Washington, D.C./Emergency Medical Service	Detroit
Washington, D.C./Suburban Sanitation	Washington
Wayland, Michigan	Grand Rapids
Wayne County/Social Services Dept.	Detroit
West Allis, Wisconsin	Milwaukee
West Miami, Florida	Miami
Wildwood, New Jersey	Philadelphia
Williamsport Redevelopment	Philadelphia
Woodbine Borough	Philadelphia
Worcester Regional	New York

Touche Ross & Co.

15. Listing of federal departments, agencies, sub-divisions or authorities for which Touche Ross & Co. performed services during each year from January 1, 1970 through December 31, 1974.

Fiscal Year Ended August 31, 1970
Commerce, Department of
HUD
Labor, Department of

Fiscal Year Ended August 31, 1971
Agency for International Development
HEW
HUD
Labor, Department of

Fiscal Year Ended August 31, 1972
Federal Communications Commission
HEW, Social and Rehabilitation Service
Labor, Department of
National Bureau of Standards
Office of Emergency Preparedness
Price Commission

Fiscal Year Ended August 31, 1973
Board of Governors - Federal Reserve System
Federal Communications Commission
Federal Home Loan Bank Board
HEW, Social and Rehabilitation Service
HUD
Justice, Department of
Labor, Department of
Office of Emergency Preparedness
Price Commission
Transportation, Department of

Fiscal Year Ended August 31, 1974
Board of Governors - Federal Reserve System
Consumer Products Safety Commission
Cost of Living Council
Federal Energy Administration
Federal Home Loan Bank Board
HEW, Social and Rehabilitation Service
HUD
Justice, Department of
Labor, Department of
Social Security Administration
Special Action Office on Drug Abuse Prevention
Transportation, Department of

Fiscal Year Ended August 31, 1975

Board of Governors - Federal Reserve System
Executive Office of the President
Federal Communications Commission
Federal Energy Administration
Federal Home Loan Bank Board
HEW, Department of Medicaid
HEW, Social and Rehabilitation Service
Labor, Department of
National Commission on Water Quality
National Corporation for Housing Partnerships
National Institute on Drug Abuse
National Institute of Education
Office of the Assistant Secretary of Defense/Health & Environment
Special Action Office for Drug Abuse Prevention
Transportation, Department of
U.S. Department of the Army

161 RUSSELL BUILDING
(202) 224-1474

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

1 March, 1976

Mr. Russell E. Palmer
Touche Ross & Co.
1633 Broadway
New York, New York 10019

Dear Mr. Palmer:

I have your response of 20 February to this subcommittee's accounting questionnaire. Your letter accompanying the response asks confidential treatment for all the information contained in the response.

As a general policy, this subcommittee does not collect information for confidential use of its members and staff. Information collected is of the type which should properly be in the public domain so that Congress and the public may be informed. The accounting questionnaire was specifically designed to avoid information which might be sensitive or affect the competitive standing of a firm.

Six of the eight firms responding to the questionnaire saw no need to request confidentiality, and the seventh requested limited confidentiality. In view of the open responses by other accounting firms and the need for authoritative information on the accounting profession by Congress and the public, I strongly urge that you reconsider your request for confidential treatment of your firm's response.

Although the questionnaire and my letter of transmittal offered no pledge of confidentiality for your response, I will honor your request if you should reaffirm it after reconsideration. However, that grant

Mr. Russell E. Palmer
1 March, 1976
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of confidentiality shall be noted in any publications or proceedings which may be undertaken by this subcommittee regarding accounting matters, and shall not extend to any information which is obviously in the public domain.

I shall appreciate a prompt response regarding reconsideration of the request for confidentiality.

Very truly yours,

Lee Metcalf

TOUCHE ROSS & CO.
1633 BROADWAY
NEW YORK, NEW YORK 10019

RUSSELL E. PALMER
Managing Partner

March 15, 1976

Honorable Lee Metcalf
United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

Thank you for your letter about our request for maintaining the confidentiality of the questionnaire data. I assure you of our desire to cooperate with the Committee's needs with minimal attention to our own interests. In this spirit we will modify the confidentiality request as follows:

1. The Committee is granted full and unqualified right to use the data submitted by Touche Ross in response to all questions.

2. With respect to the financial information submitted in response to questions 7E and 16, we prefer that any public disclosure be such that this information and comparable information from other accounting firms be collectively presented so that the Touche Ross component thereof is not separately identifiable.

I am hopeful that this clearance will provide the Committee with all flexibility necessary for your purposes.

Respectfully,

Russell E Palmer

REP/jr

MAR 17 1976

APPENDIX B

THE LIBRARY OF CONGRESS

Congressional Research Service

WASHINGTON, D.C. 20540

NYSE AND AMSE CLIENTS OF
THE BIG EIGHT ACCOUNTING FIRMS:
SUMMARY FINANCIAL AND EMPLOYMENT DATA

John Spriggs
Economic Analyst
Economics Division

July 15, 1976

NYSE AND AMSE CLIENTS OF THE BIG EIGHT ACCOUNTING FIRMS: SUMMARY FINANCIAL AND EMPLOYMENT DATA

Table of Contents

Table of Contents (con't.)

NYSE AND AMSE CLIENTS OF THE BIG EIGHT ACCOUNTING FIRMS: SUMMARY FINANCIAL AND EMPLOYMENT DATA

Background and Scope

In December 1975 the Subcommittee on Reports, Accounting, and Management of the Senate Committee on Government Operations sent questionnaires to the "big eight" Certified Public Accounting (CPA) firms in an effort to obtain heretofore unavailable information. In response to one of the Subcommittee's questions, these firms provided lists of their clients on the New York Stock Exchange (NYSE) and the American Stock Exchange (AMSE). 1/ In May 1976 the Subcommittee requested that the Congressional Research Service (CRS) determine published financial and employment data for these clients of the "big eight" CPA firms and to summarize those data for further analysis and interpretation by the Subcommittee.

In total 2,248 companies on the NYSE and the AMSE were claimed as clients of the big eight CPA firms, or approximately 85% of all companies listed on the NYSE and AMSE in 1974 (2,641 companies). Investors Management Sciences, Inc. (IMS), a subsidiary of Standard & Poor's Corporation, agreed to provide some financial and employment data for those companies in its computer files which were listed on the NYSE and the AMSE. IMS provided data for 2,397 companies. Not all of the 2,248 clients of the "big eight" CPA firms were included in the IMS listing, therefore some 130 companies' financial

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1/ CRS understands that some of the client listings provided by the eight CPA firms to the Subcommittee were provided on a confidential basis. CRS has honored this confidentiality.

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and employment data had to be obtained from published information in Standard & Poor's Corporation Records. Still, no data were obtained for 155 clients. Therefore, approximately 7% of the clients reported by the "big eight" CPA firms are not included in this report.

CRS contracted with The Mitre Corporation of McLean, Virginia to combine the aforementioned financial and employment data with the reported client lists and to summarize the data according to CRS specified guidelines (see attachment 1 for the master list of clients and their data). This study presents the Mitre summary reports, highlights some significant aspects of the reports, and relates some of the information in the reports to certain economic data--namely, employment in nonagricultural-nongovernment establishments, manufacturing, trade, and retail sales and corporate profits and corporate profits tax liability.

Summary of Financial and Employment Data

Financial and employment data were obtained for 2,093 clients of the big eight CPA firms. Table 1 is a summary of all the data by data category and by CPA firm. Data were not available for all 2,093 companies in each data category, hence Table 1A shows the number of valid entries per data category (total number of clients for whom data were available). The five categories of financial and employment data are:

1. Sales--net of excise taxes, sales taxes, etc.
2. Net income--after income taxes, before dividends
3. Income taxes--Federal, State, local, and foreign
4. Number of employees
5. Total assets

It would be ideal to obtain the most up-to-date financial and employment information on all the clients, and to have all the companies' statistics and all the comparison statistics to coincide temporally. Unfortunately, these conditions cannot be achieved because companies do not have the same year-end reporting dates and aggregate statistics are usually compiled after a lag of a year or more. The range of reporting dates in the IMS data is from January 1974 to December 1975. Since any comparison of these data with final 1974 or final 1975 aggregate statistics would not be a fair comparison, these data will be compared with the average (arithmetic mean) of 1974 and 1975 aggregate statistics.

Table 1 shows that the "big eight" CPA firms audit companies which employ at least 20.9 million people. In 1974 and 1975 the average number of employees in nonagricultural establishments was 77.1 million persons. When the 14.6 million persons in Government establishments are subtracted, this leaves 62.5 million employees in nonagricultural-nongovernment establishments. 1/ From these data approximately 1/3 of the employees in the nonagricultural-nongovernment sector are employed by companies which are clients of the "big eight" CPA firms.

Using the U.S. Department of Commerce's data for 1974 and 1975 sales by manufacturing, trade, and retail stores (not adjusted for seasonal variations), the average annual sales for these sectors amounted to $2,552.1 billion. According to Table 1 approximately 1/2 ($1,350.2 billion) of the sales in the manufacturing, trade, and retail sectors are associated with clients of the "big eight" CPA firms. Furthermore, Commerce's revised January 1976 statistics show that corporate profits after taxes were $79.5 billion in 1974 and $71.4 billion in 1975, for an annual average of $75.4 billion. Approximately 84% of these profits ($63.6 billion) are associated with the clients of these eight CPA firms.

The same U.S. Department of Commerce statistics show "after tax liability" to be $52.6 billion and $45.7 billion for 1974 and

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1/ Source: U.S. Department of Labor, Bureau of Labor Statistics.

1975, respectively. The IMS financial and employment data show that these companies paid taxes in the amount of $60.4 billion during the period January 1974 - December 1975. While there may be some definitional differences between the Commerce data and the IMS data, one explanation could be that these companies are multinational in their operations and pay a significant (but not determinable from these data) amount of income taxes to foreign governments.

These grand totals are impressive in absolute terms and in relation to the aggregate economic statistics thus far presented, especially since these data relate to the activity of only eight CPA firm's clients. Besides these grand totals, Table 1 also shows the averages for each data category. Much significance should not be placed on these averages at this time because specific clients will be examined in greater detail later in the report. Nevertheless, a quick glance at them does provide some information about which CPA firms have the largest clients on the average.

In all five categories of financial and employment data, Price Waterhouse & Co.'s clients appear to be larger on the average than the clients of each of the other CPA firms. Price Waterhouse & Co., Peat, Marwick, Mitchell & Co., and Arthur Anderson & Co. have more than 300 clients on the NYSE and AMSE, but in terms of average client financial and employment characteristics, Price Waterhouse & Co. stands above its professional counterparts.

Given this background, the remaining sections of this report will provide a more detailed analysis of these client listings. Since these listings are broken down by NYSE and AMSE the more detailed study will begin by comparing the financial and employment data of the clients listed on the exchanges.

Table 1

BIG EIGHT ACCOUNTING FIRMS:
SUMMARY OF CLIENTS' FINANCIAL AND EMPLOYMENT DATA
1974 - 1975

	SALES		NET INCOME		INCOME TAXES		EMPLOYEES		TOTAL ASSETS		CLIENTS	
	(Mil.$)	% of Total	(Mil.$)	% of Total	(Mil.$)	% of Total	(Thous.)	% of Total	(Mil.$)	% of Total	No.	% of Total
Price Waterhouse & Co. (PW)												
Total	340996.87	25.3	18969.73	29.8	23940.37	39.6	4376.37	20.9	373218.96	21.6	316	15.1
Mean*	1079.10		60.03		75.76		17.10		1181.07			
Haskins and Sells (HS)												
Total	175689.27	13.0	8503.73	13.4	5782.16	9.6	3187.60	15.3	251591.54	14.6	234	11.2
Mean*	750.81		36.34		25.03		16.52		1075.18			
Peat, Marwick, Mitchell & Co. (PMM)												
Total	166624.00	12.3	6449.97	10.1	4745.34	7.9	3060.32	14.7	302827.03	17.5	303	14.5
Mean*	551.74		21.36		15.71		12.39		1002.74			
Ernst & Ernst (EE)												
Total	103963.90	7.7	4299.19	6.8	3352.05	5.5	1669.88	8.0	142073.92	8.2	268	12.8
Mean*	387.92		16.04		12.51		7.52		530.13			
Arthur Young & Company (AY)												
Total	103738.08	7.7	4036.60	6.4	5510.09	9.1	1366.00	6.5	91411.57	5.3	181	8.6
Mean*	579.54		22.43		30.61		8.81		507.84			
Arthur Andersen & Co. (AA)												
Total	208108.11	15.4	10554.13	16.6	8819.28	14.6	3285.76	15.7	258062.93	14.9	393	18.8
Mean*	530.89		26.92		22.61		10.46		658.32			
Coopers and Lybrand (CL)												
Total	165584.05	12.3	8897.13	14.0	6814.83	11.3	2180.46	10.4	239056.36	13.8	245	11.7
Mean*	681.42		36.61		28.28		10.74		983.77			
Touche Ross & Co. (TR)												
Total	85486.64	6.3	1856.45	2.9	1464.33	2.4	1778.50	8.5	70747.58	4.1	153	7.3
Mean*	558.74		12.13		9.57		13.17		462.40			
GRAND TOTAL	1350190.92	100.0	63566.93	100.0	60428.45	100.0	20904.89	100.0	1728989.89	100.0	2093	100.0
MEAN*	646.95		30.[illegible]		29.04		12.16		828.06			

* Based on number of valid data entries (i.e., total number of client organizations less the number for whom no data was available).

Table 1A

BIG EIGHT ACCOUNTING FIRMS:
NUMBER OF VALID ENTRIES FOR DATA CATEGORY*

	Sales	Net Income	Income Taxes	Employees	Total Assets
PW	316	316	316	256	316
HS	234	234	231	193	234
PMM	302	302	302	247	302
EE	268	268	268	222	268
AY	179	180	180	155	180
AA	392	392	392	316	392
CL	243	243	241	203	243
TR	153	153	153	135	153
TOTAL	2087	2088	2081	1727	2088

*These figures represent the total number of client organizations for whom financial data was available.

Clients Listed on the NYSE and the AMSE

The NYSE reports that 1,543 companies' securities were listed on its exchange in 1974, while the AMSE reports that 1,098 companies' securities were listed on its exchange during the same period. 1/ Earlier it was noted that there were 2,248 companies listed on the NYSE and the AMSE which are clients of the big eight CPA firms. Our study of the client listings furnished by the eight CPA firms reveals that these firms had 1,417 clients on the NYSE and 831 clients on the AMSE in 1974.

Twenty-four companies were claimed as clients by at least two of the CPA firms. No effort was made to determine why these companies were claimed as clients by two firms. The list of these companies is available in Attachment 2. Table 1 shows the number of clients for which we have obtained financial and employment data. On the NYSE there were 94 clients for which we did not obtain data and on the AMSE there were 61 clients for which we did not obtain data. See Attachment 3 for the list of these companies by CPA firm. Using the client lists reported by the eight CPA firms, which includes these clients for which we do not have data, Figure 1 graphically displays the relationship between the big eight CPA firms and the number of clients on the exchanges. That is, in terms of

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1/ This information obtained directly from Thomas T. Murphy, editor of The New York Stock Exchange 1975 Fact Book, and from Colleen Reiner, Director of Marketing Research - American Stock Exchange.

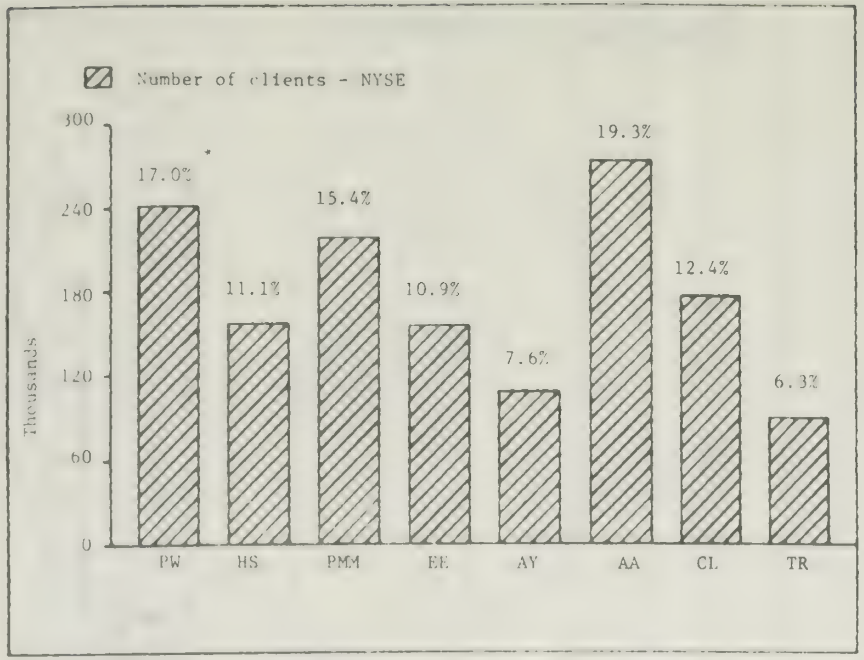
their number of clients (on the NYSE and the AMSE) no one CPA firm clearly dominates.

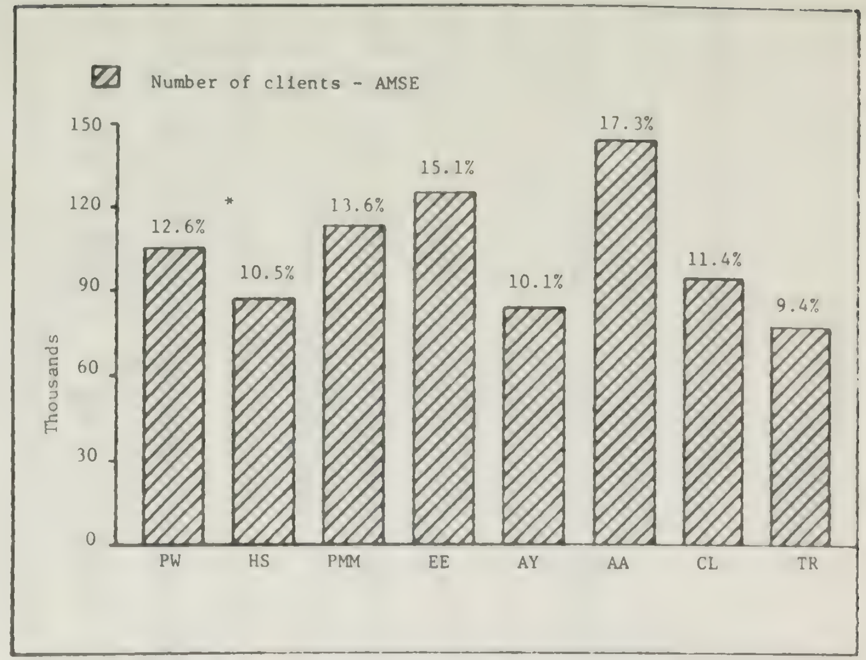
The 2,397 companies for which we received data and the 154 companies for which we researched the data gave us data on 2,551 companies listed on the NYSE and the AMSE. Adding the 155 companies for which we have no data to this total brings the total number of companies on the NYSE (1,562) and the AMSE (1,144) to 2,706. Obviously, this is greater than the number of companies reported by the exchanges in 1974 (2,641). Since the IMS data cover the period from January 1974 to December 1975, this discrepancy is not a major cause of concern.

Figure 2 relates the number of clients listed on the NYSE and the AMSE for each of the eight CPA firms to the total number of companies listed on the respective exchanges (as opposed to the "big eight" CPA firm's clients exclusively). Ninety and seven-tenths percent (90.7%) of all the companies listed on the NYSE are clients of the "big eight" CPA firms. Seventy-two and six-tenths percent (72.6%) of all the companies on the AMSE are clients of the "big eight" CPA firms. The dominance of the eight CPA firms is more pronounced on the NYSE where the Nation's "blue-chip stock" companies are registered.

Figure 1

BIG EIGHT ACCOUNTING FIRMS:
NUMBER OF CLIENTS
1974 - 1975





* Percentages show what proportion of the "big eight" CPA firm's clients (on the respective exchanges) are associated with each CPA firm.

Source: Economics Division, CRS.

NUMBER OF CLIENTS (THOUS.)

	NYSE	AMSE
PW	241	105
HS	157	87
PMM	218	113
EE	155	125
AY	108	84
AA	273	144
CL	176	95
TR	89	78
	1,417	831

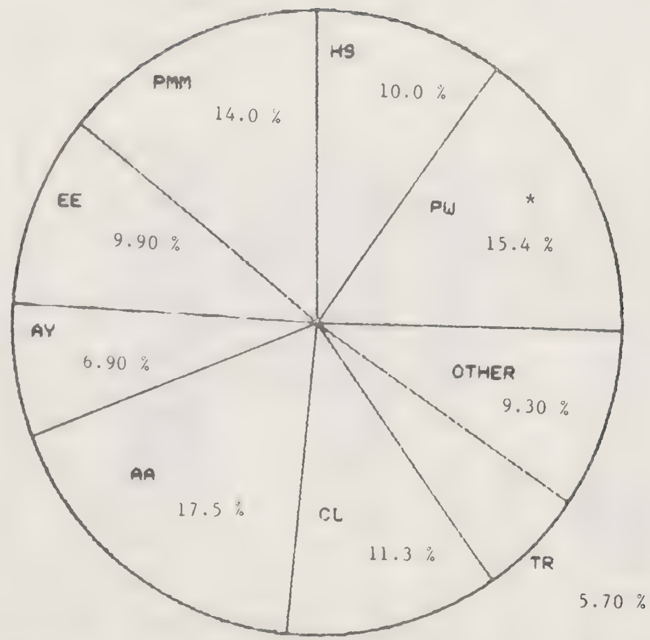
CRS-12

Figure 2

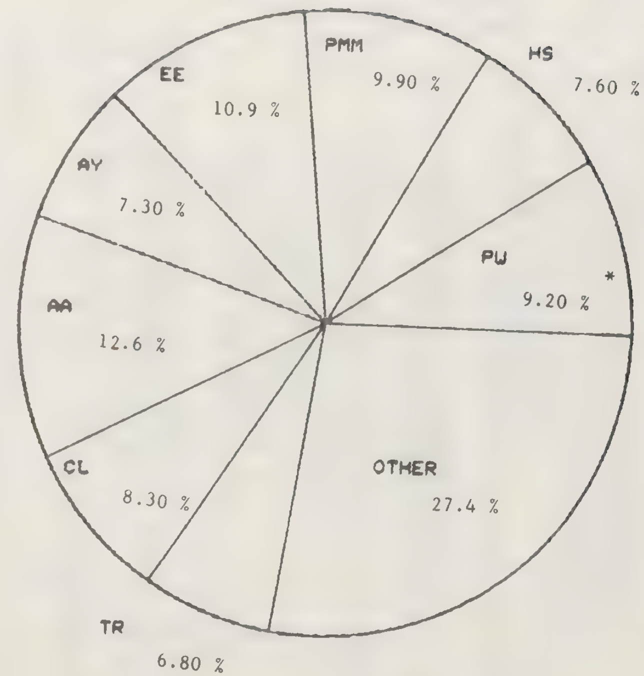
BIG EIGHT ACCOUNTING FIRMS:
NUMBER OF CLIENTS
1974 - 1975

Percentage of all companies listed on the exchanges

NYSE



AMSE



* Percentages show what proportion of all companies listed on the respective exchanges are associated with each CPA firm (as opposed to the "big eight" CPA firm's clients exclusively).

Source: Economics Division, CRS.

Note: (1) "Other" denotes companies listed on the respective exchanges which are not clients of the "big eight" CPA firms. (2) Total number of companies listed on the NYSE according to our research is 1,562. (3) Total number of companies listed on the AMSE according to our research is 1,144.

Clients Financial and Employment Data

The bar graphs in Figures 3 - 12 show: (1) the absolute amounts of sales, net income, income taxes, number of employees, and total assets of clients for each of the eight CPA firms; (2) the percentage that these absolute amounts represent with respect to all of the clients of the eight CPA firms (for which we have data); and (3) these absolute amounts and percentages for the NYSE and the AMSE. 1/ The pie charts in Figures 3 - 12 relate the financial and employment data categories for the clients listed on the exchanges to the corresponding data categories for all companies listed on each exchange (for which we have data).

The clients of the big eight CPA firms account for a significant proportion of all the financial and employment data categories for listed companies on the NYSE and, to a lesser extent, for companies listed on the AMSE. For all the companies listed on the NYSE, the following percentages show what proportion of the respective data categories are associated with clients of the big eight firms:

1. 93.7% of all sales (revenues) received
2. 94.1% of all profits earned
3. 89.9% of all income taxes paid
4. 94.1% of all people employed
5. 93.7% of all assets owned

1/ The 2,397 companies for which we received data from IMS and the 154 companies for which we researched the data gave us grand totals for the NYSE and the AMSE. These grand totals are the basis upon which these percentages are computed. To get these grand totals, sum the totals for each accounting firm and the "Other" group for each exchange.

For all the companies listed on the AMSE, the following percentages show what proportion of the respective data categories are associated with clients of the big eight CPA firms:

1. 66.9% of all sales (revenues) received
2. 66.7% of all profits earned
3. 65.8% of all income taxes paid
4. 61.2% of all people employed
5. 72.8% of all assets owned

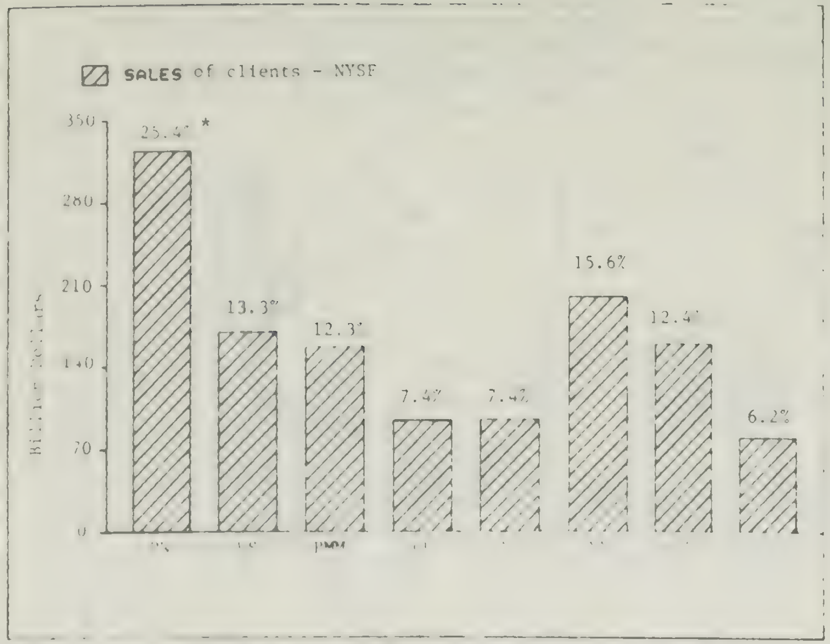
In looking at the performance of the clients of the eight CPA firms as represented by the NYSE graphs and charts, a recurring pattern emerges which indicates that these eight CPA firms can be grouped into three segments: (1) Price Waterhouse & Co.; (2) Arthur Andersen & Co., Coopers and Lybrand, Haskins & Sells, and Peat, Marwick, Mitchell & Co.; and (3) Ernst & Ernst, Arthur Young & Company, and Touche Ross & Co. This same grouping is evident in the AMSE graphs and charts, but not with the clarity of the NYSE figures.

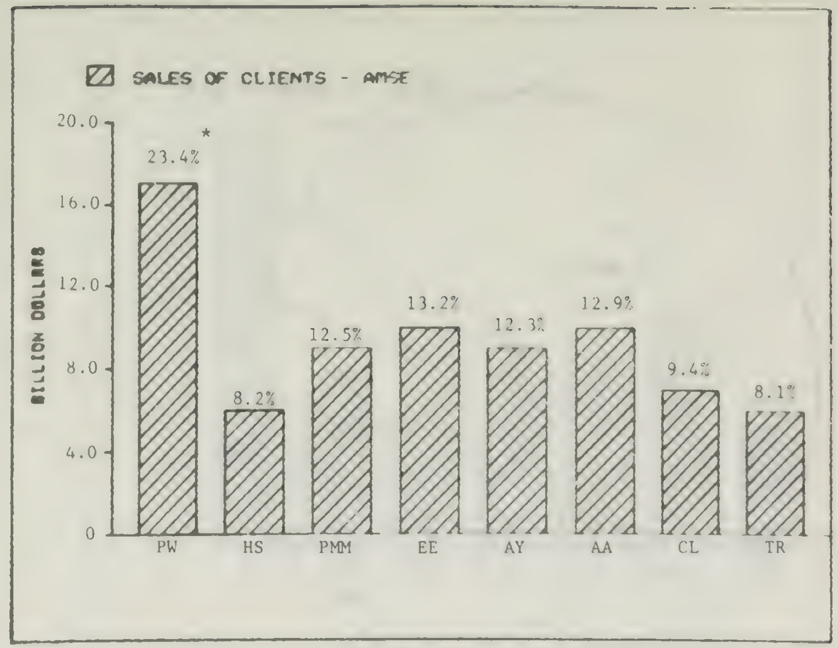
Earlier in this report it was noted that Price Waterhouse & Co.'s clients appeared to be larger on the average than the client's of each of the other CPA firms. Figures 3 - 12 seem to corroborate this earlier observation. So far our study of these data has not yielded any insights into why this is the case. No financial or employment statistics in the summary appears to be significantly different with respect to Price Waterhouse & Co. Further research in this regard may reveal some determining factors or statistics which explain what appears to be "preeminence" of this firm, but now all one can do is note it without explaining any reasons.

CRS-15

Figure 3

BIG EIGHT ACCOUNTING FIRMS:
SALES OF CLIENTS
1974 - 1975





* Percentages show what proportion of the sales of clients (listed on respective exchanges) are associated with each CPA firm.

Note: There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). These bar graphs and percentages are based on those clients for which data have been obtained.

Source: Economics Division, CRS.

SALES OF CLIENTS (BILLION $)

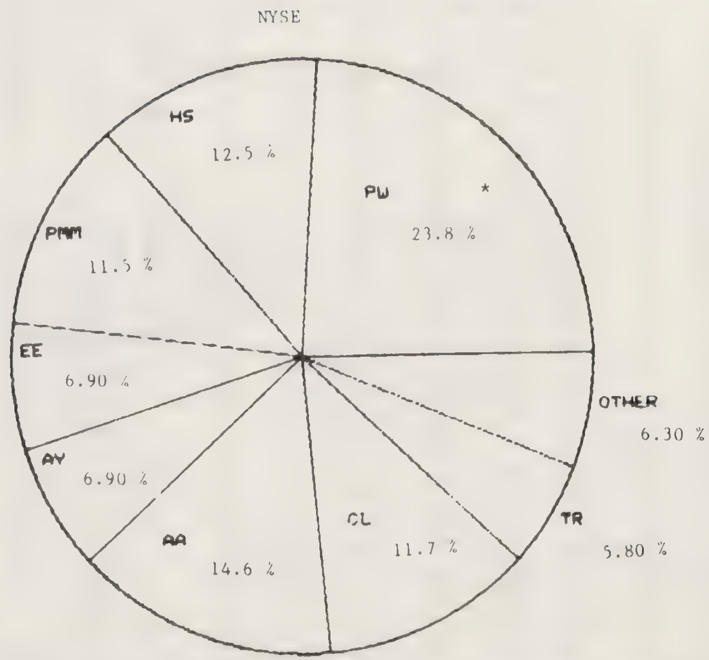
	NYSE	AMSE
PW	324	17
HS	170	6
PMM	157	9
EE	94	10
AY	95	9
AA	199	10
CL	159	7
TR	80	6
	1,276	74

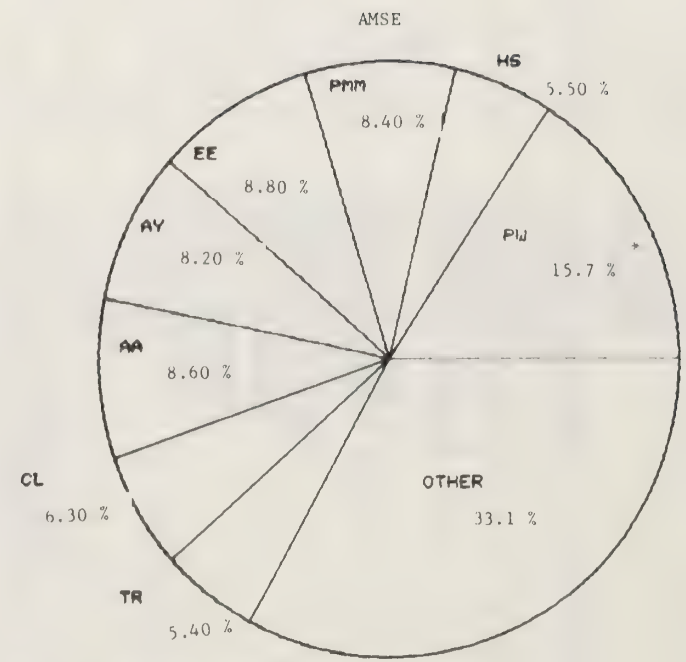
CRS-16

Figure 4

BIG EIGHT ACCOUNTING FIRMS:
SALES OF CLIENTS
1974 - 1975

Percentage of sales of all companies listed on the exchanges





* Percentages show what proportion of the sales of all companies listed on the respective exchanges are associated with each CPA firm (as opposed to the "big eight" CPA firm's clients exclusively).

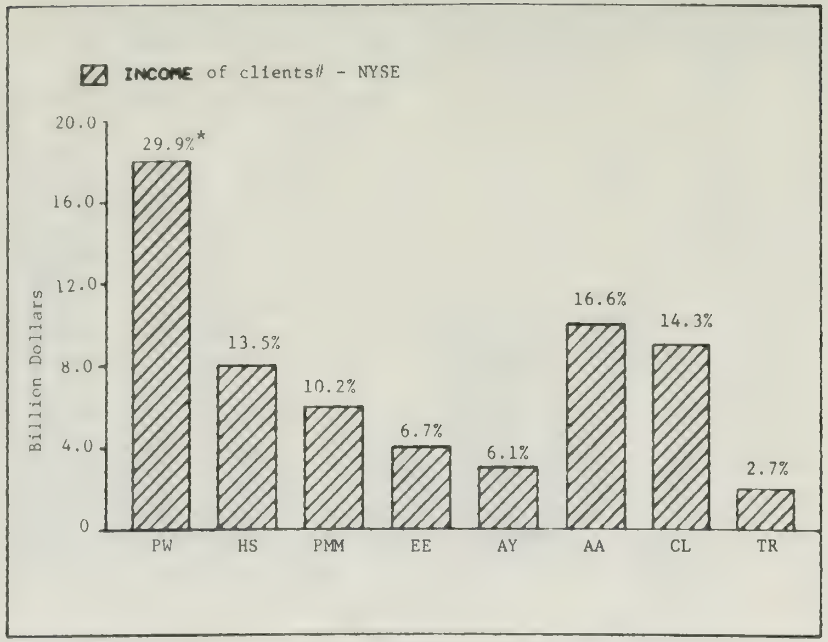
Note: (1) "Other" denotes companies listed on the respective exchanges which are not clients of the "big eight" CPA firms. (2) There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). (3) Total sales of all companies listed on the NYSE, according to our research, is $1,361 billion. (4) Total sales of all companies listed on the AMSE, according to our research, is $110.8 billion.

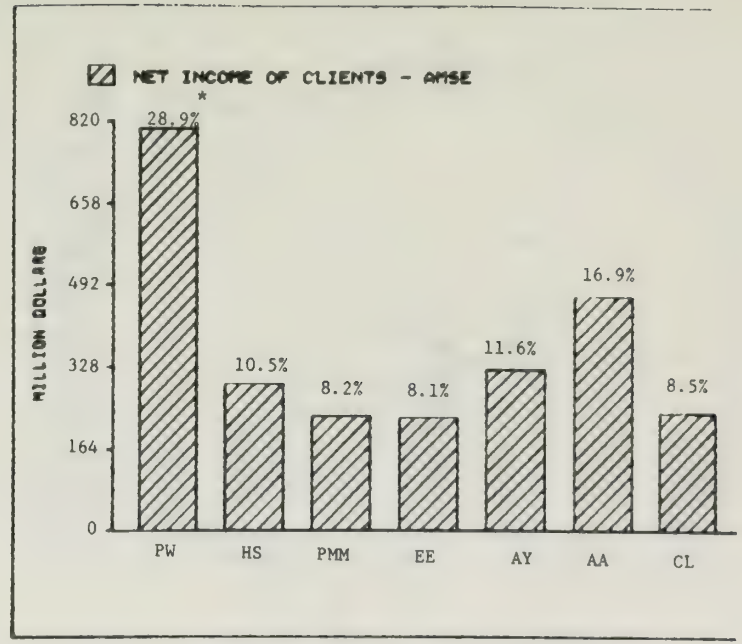
Source: Economics Division, CRS.

CRS-17

Figure 5

BIG EIGHT ACCOUNTING FIRMS:
NET INCOME OF CLIENTS
1974 - 1975





\# Net income after taxes, but before dividends.

* Percentages show what proportion of the sales of clients (listed on respective exchanges) are associated with each CPA firm.

Note: There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). These bar graphs and percentages are based on those clients for which data have been obtained.

Source: Economics Division, CRS.

NET INCOME OF CLIENTS

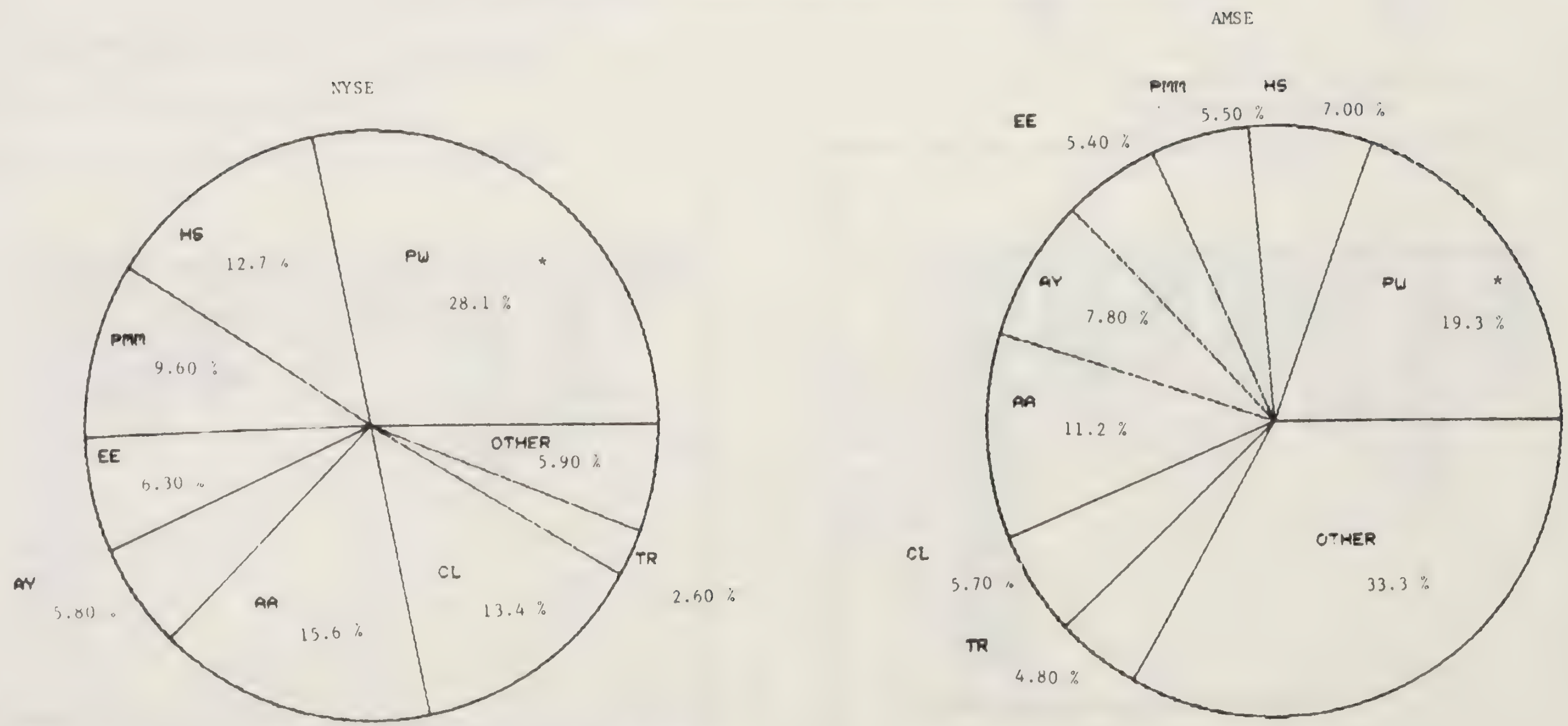
	NYSE (Billion $)	AMSE (Million $)
PW	18	805
HS	8	293
PMM	6	229
EE	4	226
AY	3	324
AA	10	468
CL	9	237
TR	2	202
	61	2,784

CRS-18

Figure 6

BIG EIGHT ACCOUNTING FIRMS:
NET INCOME OF CLIENTS
1974 - 1975

Percentage of net income of all companies listed on the exchanges



* Percentages show what proportion of the sales of all companies listed on the respective exchanges are associated with each CPA firm (as opposed to the "big eight" CPA firm's clients exclusively).

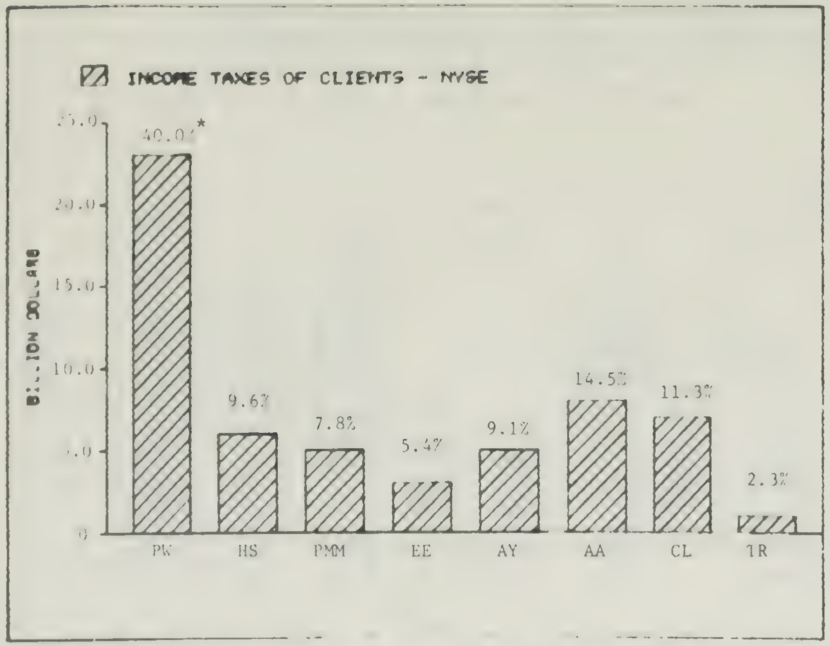
Note: (1) "Other" denotes companies listed on the respective exchanges which are not clients of the "big eight" CPA firms. (2) There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). (3) Total net income of all companies listed on the NYSE, according ot our research, is $64.6 billion. (4) Total net income of all companies listed on the AMSE, according to our research, is $4,173 million.

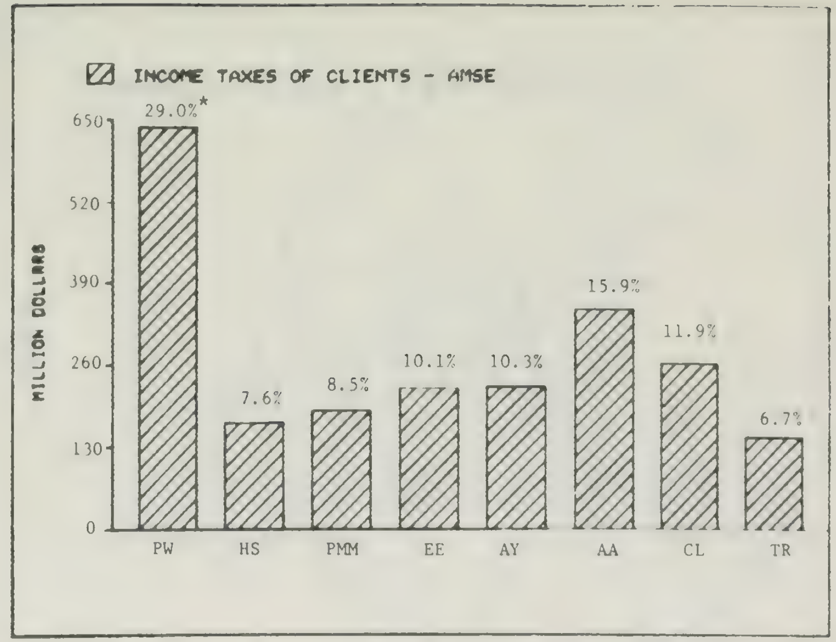
Source: Economics Division, CRS.

CRS-19

Figure 7

BIG EIGHT ACCOUNTING FIRMS:
INCOME TAXES OF CLIENTS
1974 - 1975





* Percentages show what proportion of the sales of clients (listed on respective exchanges) are associated with each CPA firm.

Note: There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). These bar graphs and percentages are based on those clients for which data have been obtained.

Source: Economics Division, CRS.

INCOME TAXES OF CLIENTS

	NYSE (Billion $)	AMSE (Million $)
PW	23	638
HS	6	168
PMM	5	187
EE	3	222
AY	5	226
AA	8	349
CL	7	263
TR	1	147
	58	2,200

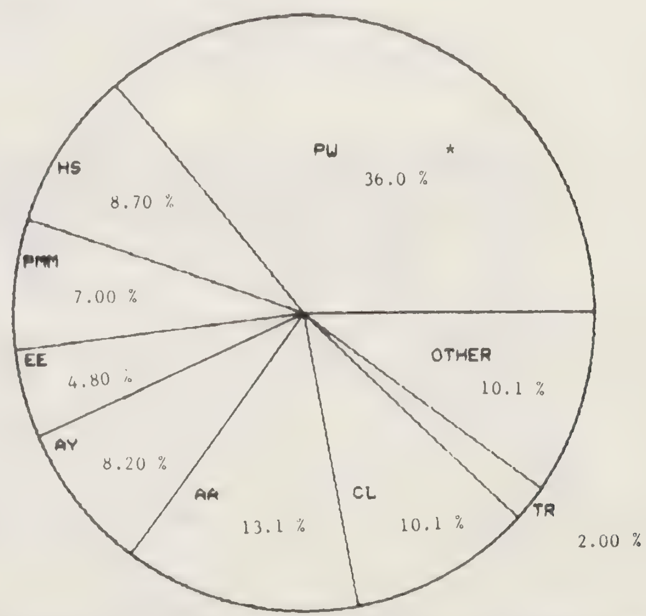
CRS-20

Figure 8

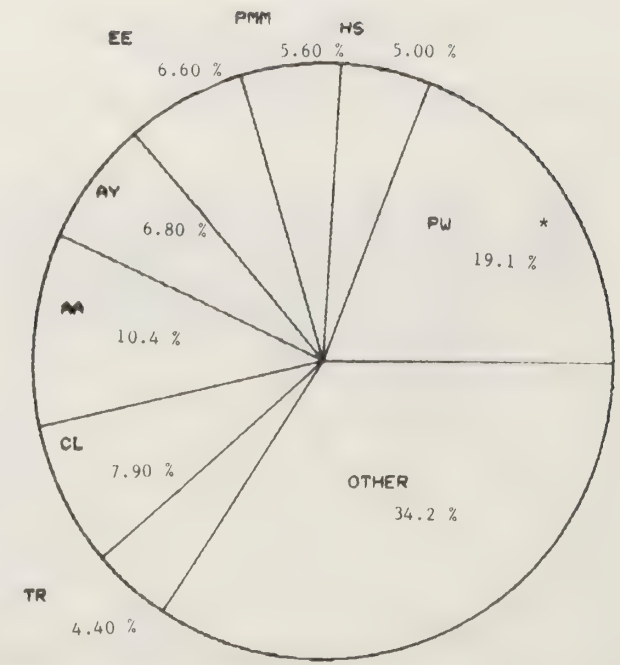
BIG EIGHT ACCOUNTING FIRMS:
INCOME TAXES OF CLIENTS
1974 - 1975

Percentage of income taxes of all companies listed on the exchanges

NYSE



AMSE



* Percentages show what proportion of the sales of all companies listed on the respective exchanges are associated with each CPA firm (as opposed to the "big eight" CPA firm's clients exclusively).

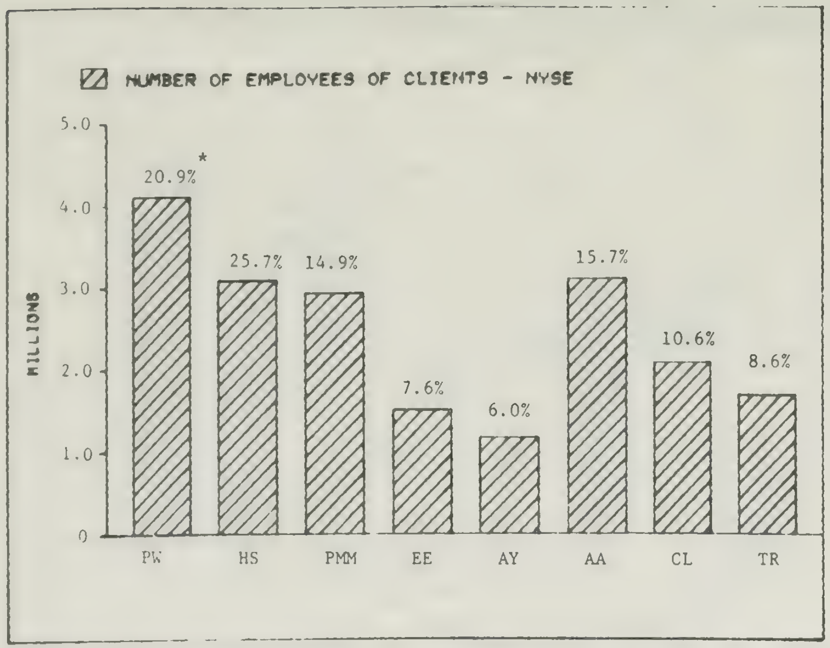
Note: (1) "Other denotes companies listed on the respective exchanges which are not clients of the "big eight" CPA firms. (2) There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). (3) Total income taxes of all companies listed on the NYSE, according to our research, are $64.8 billion. (4) Total income taxes of all companies listed on the AMSE, according to our research, are $3,345 million.

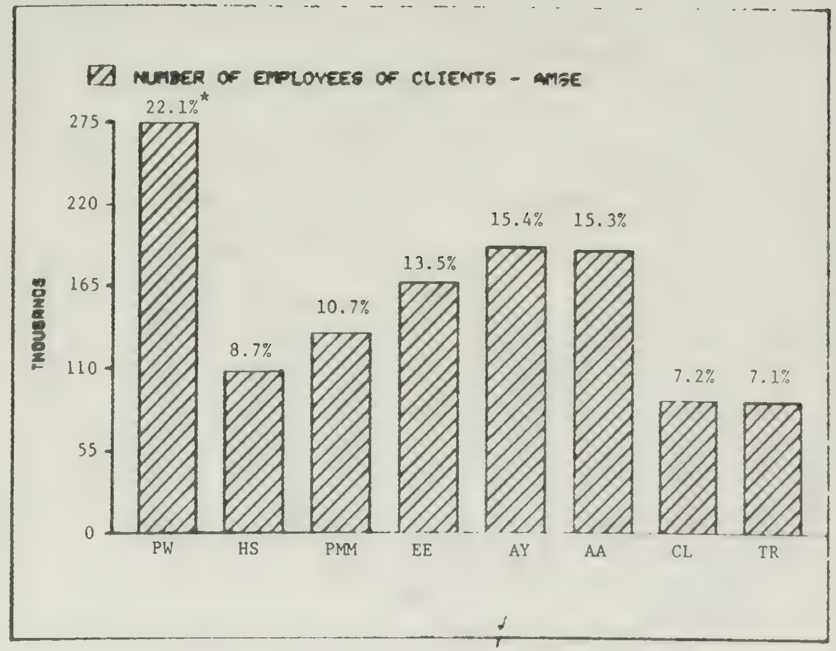
Source: Economics Division, CRS.

CRS-21

Figure 9

BIG EIGHT ACCOUNTING FIRMS:
NUMBER OF EMPLOYEES OF CLIENTS
1974 - 1975





* Percentages show what proportion of the sales of clients (listed on respective exchanges) are associated with each CPA firm.

Note: There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). These bar graphs and percentages are based on those clients for which data have been obtained.

Source: Economics Division, CRS.

NUMBER OF EMPLOYEES OF CLIENTS

	NYSE (Millions)	AMSE (thousands)
PW	4	274
HS	3	108
PMM	3	133
EE	2	167
AY	1	191
AA	3	189
CL	2	89
TR	2	88
	20	1,239

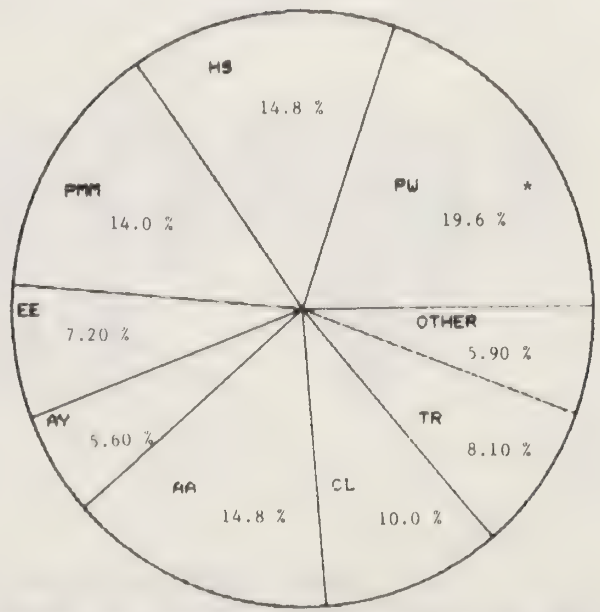
CRS-22

Figure 10

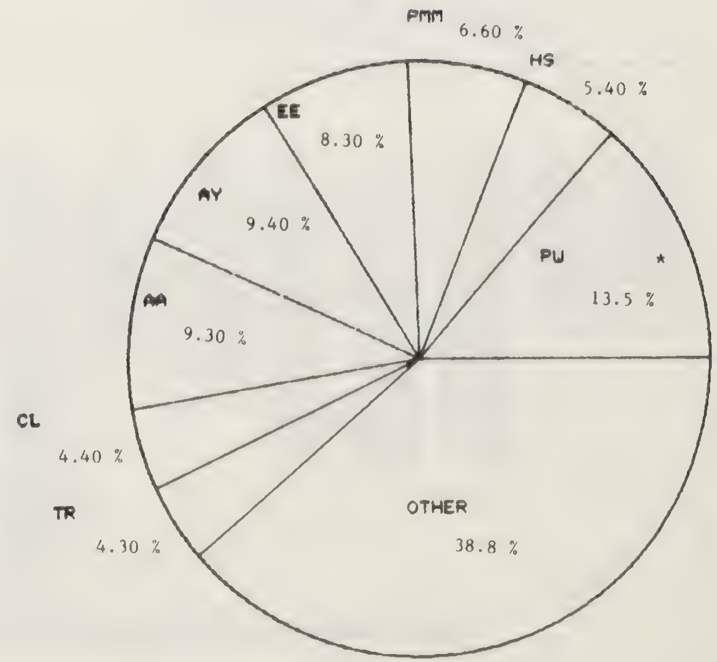
BIG EIGHT ACCOUNTING FIRMS:
NUMBER OF EMPLOYEES OF CLIENTS
1974 - 1975

Percentage of employees of all companies listed on the exchanges

NYSE



AMSE



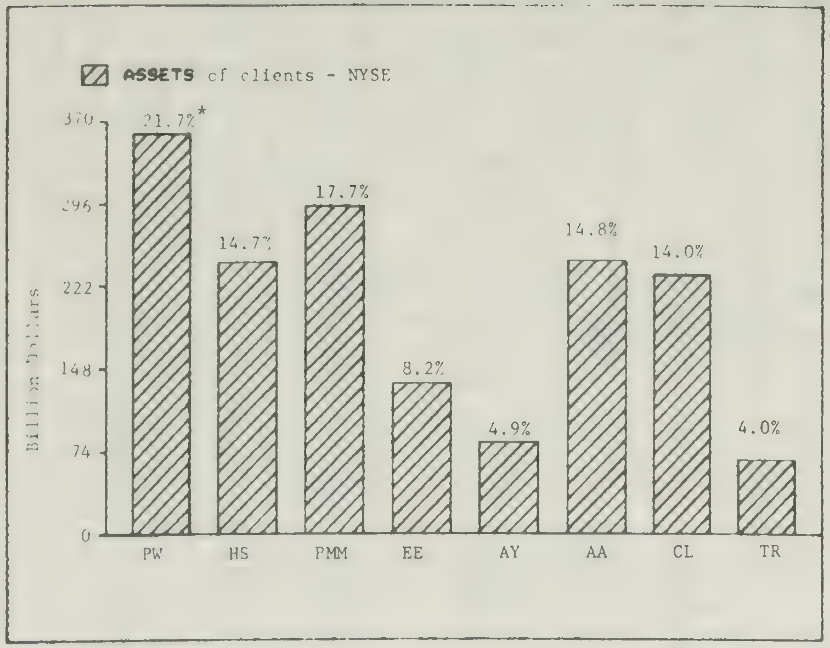
*Percentages show what proportion of the sales of all companies listed on the respective exchanges are associated with each CPA firm (as opposed to the "big eight" CPA firm's clients exclusively).

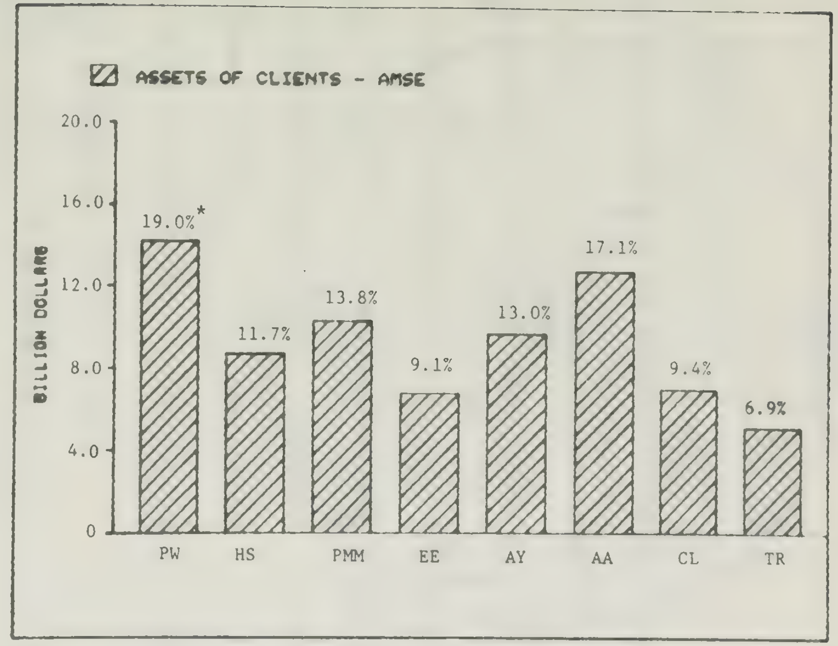
Note: (1) "Other" denotes companies listed on the respective exchanges which are not clients of the "big eight" CPA firms. (2) There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). (3) Total number of employees of all companies listed on the NYSE, according to our research, is 20,894 million. (4) Total number of employees of all companies listed on the AMSE, accmrding to our research, are 2,024 million.

Source: Economics Division, CRS.

Figure 11

BIG EIGHT ACCOUNTING FIRMS:
ASSET OF CLIENTS
1974 - 1975





* Percentages show what proportion of the sales of clients (listed on respective exchanges) are associated with each CPA firm.

Note: There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). These bar graphs and percentages are based on those clients for which data have been obtained.

Source: Economics Division, CRS.

ASSETS OF CLIENTS (BILLION $)

	NYSE	AMSE
PW	359	14
HS	243	9
PMM	293	10
EE	135	7
AY	82	10
AA	245	13
CL	232	7
TR	66	5
	1,654	75

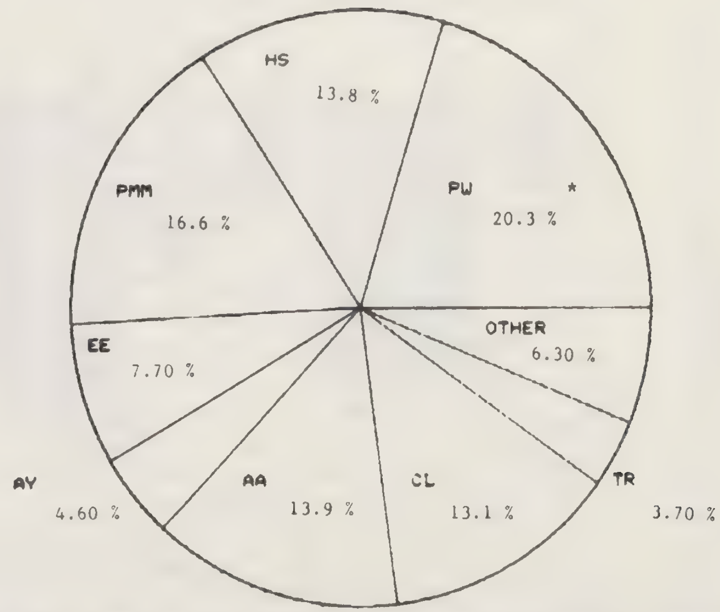
CRS-24

Figure 12

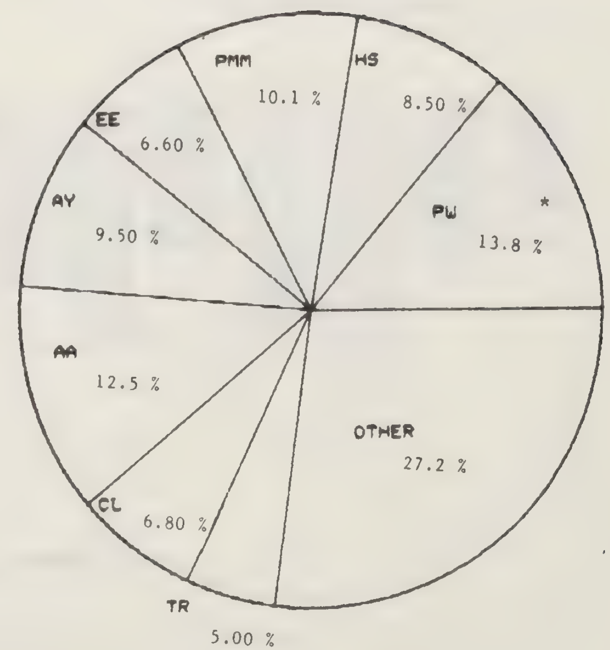
BIG EIGHT ACCOUNTING FIRMS:
TOTAL ASSETS OF CLIENTS
1974 - 1975

Percentage of total assets of companies listed on the exchanges

NYSE



AMSE



* Percentages show what proportion of the sales of all companies listed on the respective exchanges are associated with each CPA firm (as opposed to the "big eight" CPA firm's clients exclusively).

Note: (1) "Other" denotes companies listed on the respective exchanges which are not clients of the "big eight" CPA firms. (2) There are 155 clients for which we have no financial and employment data (approximately 7% of the 2,248 clients). (3) Total assets of all companies listed on the NYSE, according to our research, are $1,765 billion. (4) Total assets of all companies listed on the AMSE, according to our research, are $102.45 billion.

Source: Economics Division, CRS.

Fifty Largest Clients

Tables 2 - 6 present five lists (one for each data category) of the fifty largest clients (ranked by respective financial and employment statistics) with all eight firm's clients taken into consideration. 1/ Upon inspection it is found that some companies appear on more than one list, since one would generally expect the largest companies with respect to sales to be among the largest ones with respect to assets, employees, etc. It is also seen that almost all the companies on these lists are from the NYSE with only three companies from the AMSE.

In terms of these fifty largest clients lists, one sees the recurring pattern noted in the preceding section--that is the alignment of this group of eight CPA firms into three distinct segments. Because of the overlapping noted earlier between these five lists, relatively little importance should be placed on this segmentation. Nonetheless, the following summary of the number of clients that each CPA firm has on the respective fifty largest clients lists may prove interesting and informative. For example,

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1/ If, in addition to the eight CPA firms, you take into consideration the "Other" group of companies not audited by the "big eight" CPA firms, then six other companies would be included in these fifty largest clients lists. These companies are: (1) British Petroleum Co., (2) Union Carbide Corp., (3) Unilever Ltd., (4) Federal National Mortgage Assn., (5) British-American Tobacco Co., and (6) Imperial Group. Furthermore, no data were received for 155 clients of the eight CPA firms. Consequently, the impact of these companies on the fifty largest clients lists is not known.

Price Waterhouse & Co. has no less than 14 clients on each of the lists and all eight CPA firms have at least one client on each of the lists. The data show as well the three distinct firm groupings listed above.

CPA Firms	Sales	Income	Taxes	Employees	Assets
PW	17	16	15	14	14
AA	8	11	9	7	9
CL	5	7	7	4	6
HS	6	7	6	9	6
PMM	6	3	5	7	9
EE	1	2	3	2	2
AY	5	3	4	2	1
TR	2	1	1	5	3
	50	50	50	50	50

The Mitre Report takes this ranking approach one step further by presenting all the clients of each CPA firm in order of their sales (first for the NYSE clients, then for the AMSE clients). Further ranking of the clients according to the other four financial and employment data categories was considered, but the cost, as well as the volume of space which would have been necessary to report the results, was prohibitive. (Note: A copy of this master ranking of clients by sales is available upon request subject to the approval of the subcommittee and CRS.)

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Table 2

BIG EIGHT ACCOUNTING FIRMS:
FIFTY LARGEST CLIENTS RANKED BY SALES*
1974 - 1975

CLIENT NAME	LIST	EXCH	SALES	NET INCOME	TAXES	EMPLOYEES	ASSETS
1. EXXON CORP	PW	NYSE	44865.01	2503.00	7279.00	137.00	32839.41
2. GEN MOTORS	HS	NYSE	35724.91	1253.09	1118.20	681.00	21664.91
3. AM TEL & TEL	CL	NYSE	28957.21	3147.72	2390.24	0.0	80156.18
4. TEXACO INC	AA	NYSE	24507.50	830.58	982.05	75.24	17262.40
5. FORD MOTOR	CL	NYSE	24009.10	227.50	151.90	416.12	14020.20
6. MOBIL OIL	AY	NYSE	20620.41	809.88	2363.15	0.0	15050.30
7. ROYAL D PET	PW	NYSE	19795.30	1626.93	3862.64	98.40	18140.80
8. STD OIL-CAL	PW	NYSE	16822.10	772.51	632.24	38.80	12898.20
9. INTL BUS MA	PW	NYSE	14436.50	1989.88	1731.00	288.65	15530.50
10. GULF OIL CP	PW	NYSE	14268.00	700.00	2012.00	52.10	12425.00
11. GEN ELECTRC	PMM	NYSE	13399.10	580.80	358.00	375.00	9763.50
12. SEARS ROE	TR	NYSE	13101.20	511.39	304.20	437.00	11339.40
13. CHRYSLER CP	TR	NYSE	11598.40	-207.21	26.40	217.59	6266.73
14. INTL TEL & TL	AA	NYSE	11367.50	398.17	333.24	376.00	10407.90
15. STD OIL-IND	PW	NYSE	9955.25	786.99	1179.44	46.81	9854.09
16. SAFEWAY STR	PMM	NYSE	9716.89	148.63	126.50	126.96	1574.67
17. U S STEEL	PW	NYSE	8167.20	559.60	264.00	172.80	8148.20
18. SHELL OIL	PW	NYSE	8143.45	514.83	379.12	32.50	7010.75
19. UNILEVER NV	PW	NYSE	7891.94	207.41	188.15	0.0	4169.04
20. PENNEY J C	PMM	NYSE	7678.60	189.60	161.60	186.00	3226.00
21. ATLANTIC RIC	CL	NYSE	7307.85	350.39	545.96	28.10	7364.78
22. CONT OIL CO	AY	NYSE	7253.80	330.85	660.70	44.03	5184.58
23. DUPONT (EI)	PW	NYSE	7221.50	271.80	176.50	132.24	6425.00
24. KRESGE S.S	PW	NYSE	6883.61	200.83	197.30	0.0	2377.54
25. GRT A&P TEA	HS	NYSE	6874.61	-157.07	-11.20	105.00	1020.71
26. PROCTR & GM	HS	NYSE	6081.67	333.86	287.77	51.00	3652.67
27. AETNA LIFE	PMM	NYSE	6072.33	101.66	2.52	0.0	15464.40
28. GEN TEL & TEL	AA	NYSE	5948.39	388.16	390.09	187.00	12713.70
29. WESTNGHS EL	PW	NYSE	5862.74	178.62	93.84	166.05	4866.28
30. ENGELHARD	AA	NYSE	5672.52	114.72	61.31	0.0	1325.06
31. TENNECO INC	AA	NYSE	5630.33	342.94	256.15	78.38	6584.20
32. GOODYR TIRE	PW	NYSE	5452.47	161.61	155.25	148.23	4173.67
33. OCCID PETE	AA	NYSE	5345.94	174.61	441.37	32.94	3503.37
34. KROGER CO	CL	NYSE	5339.22	34.44	24.79	56.97	1084.74
35. INTL HARVST	HS	NYSE	5246.04	115.92	59.73	104.17	3510.34
36. PHILLIP PET	AY	NYSE	5133.55	342.57	409.45	30.51	4544.92
37. UNION O-CAL	CL	NYSE	5086.42	232.75	238.10	15.67	3776.12
38. BETHLHM STL	PW	NYSE	4977.20	242.00	41.00	113.00	4591.50
39. CATERPILLAR	PW	NYSE	4963.69	398.70	248.80	78.29	3386.60
40. EASTMN KODK	PW	NYSE	4958.53	613.69	493.00	124.00	5056.23
41. ROCKWEL INT	HS	NYSE	4943.40	101.60	73.70	122.79	2888.10
42. CITICORP	PMM	NYSE	4936.57	348.20	263.19	44.60	57849.71
43. DOW CHEMICL	HS	NYSE	4888.11	615.66	475.30	53.10	5846.73
44. MATSUSHITA EL	PMM	NYSE	4885.41	180.50	229.71	88.18	4192.07
45. KRAFTCO CP	AA	NYSE	4857.37	139.55	128.68	0.0	1671.17
46. REYNLDS R J	EE	NYSE	4837.64	338.67	478.57	34.67	3294.32
47. RCA CORP	AY	NYSE	4789.50	110.00	78.60	113.00	3728.40
48. ESMARK INC	AY	NYSE	4730.73	79.69	69.80	33.60	1473.92
49. MARCOR	AA	NYSE	4667.48	120.38	105.66	120.90	3169.02
50. WOOLWRTH FW	PW	NYSE	4650.29	99.52	77.95	0.0	2173.08
		TOTALS	510524.48	24458.12	32596.66	5864.39	498641.11

* Sales, net income, taxes, assets are in billion dollars. Employees are in thousands.

Note: A blank field in the original data is denoted by 0.0 to distinguish it from a legitimate value of zero which is denoted by 0.00.

Table 3

BIG EIGHT ACCOUNTING FIRMS:
FIFTY LARGEST CLIENTS RANKED BY NET INCOME*
1974 - 1975

CLIENT NAME	LIST	EXCH	SALES	NET INCOME	TAXES	EMPLOYEES	ASSETS
1. AM TEL & TEL	CL	NYSE	28957.21	3147.72	2390.24	0.0	80156.18
2. EXXON CORP	PW	NYSE	44865.01	2593.00	7279.00	137.00	32839.41
3. INTL BUS MA	PW	NYSE	14436.50	1989.88	1731.00	288.65	15530.50
4. ROYALD D PET	PW	NYSE	19795.30	1626.93	3862.64	98.40	18140.80
5. GEN MOTORS	HS	NYSE	35724.91	1253.09	1118.20	681.00	21664.91
6. TEXACO INC	AA	NYSE	24507.50	830.58	982.05	75.24	17262.40
7. MOBIL OIL	AY	NYSE	20620.41	809.88	2363.15	0.0	15050.30
8. STD OIL-IND	PW	NYSE	9955.25	786.99	1179.44	46.81	9854.09
9. STD OIL-CAL	PW	NYSE	16822.10	772.51	632.24	38.80	12898.20
10. GULF OIL CP	PW	NYSE	14268.00	700.00	2012.00	52.10	12425.00
11. DOW CHEMICL	HS	NYSE	4888.11	615.66	475.30	53.10	5846.73
12. EASTMN KODK	PW	NYSE	4958.53	613.69	493.00	124.00	5056.23
13. GEN ELECTRC	PMM	NYSE	13399.10	580.80	358.00	375.00	9763.50
14. U S STEEL	PW	NYSE	8167.20	559.60	264.00	172.80	8148.20
15. SHELL OIL	PW	NYSE	8143.45	514.83	379.12	32.50	7010.75
16. SEARS ROE	TR	NYSE	13101.20	511.39	304.20	437.00	11339.40
17. CATERPILLAR	PW	NYSE	4963.69	398.70	248.80	78.29	3386.60
18. INTL TEL & TL	AA	NYSE	11367.50	398.17	333.24	376.00	10407.90
19. GEN TEL & EL	AA	NYSE	5948.39	388.16	390.09	187.00	12713.70
20. ATLANTC RIC	CL	NYSE	7307.85	350.39	545.96	28.10	7364.78
21. CITICORP	PMM	NYSE	4936.57	348.20	263.19	44.60	57849.71
22. TENNECO INC	AA	NYSE	5630.33	342.94	256.15	78.38	6584.20
23. PHILLIP PET	AY	NYSE	5133.55	342.57	409.45	30.51	4544.92
24. XEROX CORP	PMM	NYSE	4053.76	341.63	342.60	93.53	4455.64
25. REYNLDS R J	EE	NYSE	4837.64	338.67	478.57	34.67	3294.32
26. PROCTR & GM	HS	NYSE	6081.67	333.86	287.77	51.00	3652.67
27. CONT OIL CO	AY	NYSE	7253.80	330.85	660.70	44.03	5184.58
28. PAC TEL & TEL	CL	NYSE	3289.77	310.95	256.47	94.72	8249.98
29. MONSANTO CO	HS	NYSE	3624.70	306.30	230.00	59.24	3450.90
30. SOUTHN CO	AA	NYSE	1998.91	278.77	187.64	0.0	7237.00
31. CONS EDISON	PW	NYSE	2667.94	274.73	53.91	24.65	6315.41
32. DUPONT (EI)	PW	NYSE	7221.50	271.80	176.50	132.24	6425.00
33. MINN MIN&MF	HS	NYSE	3127.34	261.62	195.00	78.43	3016.76
34. MINN MIN&MF	CL	NYSE	3127.34	261.62	195.00	78.43	3016.76
35. GETTY OIL	AA	NYSE	2983.58	256.69	451.23	11.69	3239.86
36. PAC G & E	HS	NYSE	2233.37	251.58	4.91	24.99	6620.88
37. AM HOME PRD	AA	NYSE	2258.64	250.69	238.18	46.39	1390.71
38. IMPRL OIL	PW	AMEX	4047.00	250.00	240.00	15.32	2950.00
39. BETHLHM STL	PW	NYSE	4977.20	242.00	41.00	113.00	4591.50
40. AM ELEC PWR	HS	NYSE	1644.22	239.76	14.89	18.39	6408.28
41. COCA-CL CO	EE	NYSE	2872.84	239.31	220.91	0.0	1710.87
42. UNION O-CAL	CL	NYSE	5086.42	232.75	238.10	15.67	3776.12
43. MERCK & CO	AA	NYSE	1489.66	228.78	147.70	26.80	1573.69
44. FORD MOTOR	CL	NYSE	24009.10	227.50	151.90	416.12	14020.20
45. HALLIBURTON	AA	NYSE	4209.60	222.51	181.32	85.25	2092.07
46. SUN OIL CO	CL	NYSE	4389.12	220.05	386.35	27.85	4383.51
47. SCHLUMBERGR	PW	NYSE	1565.57	219.34	125.39	0.0	1715.67
48. SO CAL EDISON CO	AA	AMEX	1483.43	218.30	135.14	13.47	4403.94
49. INTL PAPER	AA	NYSE	3080.80	218.00	153.30	50.84	3341.00
50. COURTAULDS	PW	AMEX	2730.43	214.55	70.56	110.93	2666.14
		TOTALS	444243.01	27428.29	34135.50	5102.93	505021.87

* Sales, net income, taxes, assets are in billion dollars. Employees are in thousands.

Note: A blank field in the original data is denoted by 0.0 to distinguish it from a legitimate value of zero which is denoted by 0.00.

Table 4

BIG EIGHT ACCOUNTING FIRMS:
FIFTY LARGEST CLIENTS RANKED BY TAXES*
1974 - 1975

CLIENT NAME	LIST	EXCH	SALES	NET INCOME	TAXES	EMPLOYEES	ASSETS
1. EXXON CORP	PW	NYSE	44865.01	2503.00	7279.00	137.00	32839.41
2. ROYAL D PET	PW	NYSE	19795.30	1626.93	3862.64	98.40	18140.80
3. AM TEL & TEL	CL	NYSE	28957.21	3147.72	2390.24	0.0	80156.18
4. MOBIL OIL	AY	NYSE	20620.41	809.88	2363.15	0.0	15050.30
5. GULF OIL CP	PW	NYSE	14268.00	700.00	2012.00	52.10	12425.00
6. INTL BUS MA	PW	NYSE	14436.50	1989.88	1731.00	288.65	15530.50
7. STD OIL-IND	PW	NYSE	9955.25	786.99	1179.44	46.81	9854.09
8. GEN MOTORS	HS	NYSE	35724.91	1253.09	1118.20	681.00	21664.91
9. TEXACO INC	AA	NYSE	24507.50	830.58	982.05	75.24	17262.40
10. CONT OIL CO	AY	NYSE	7253.80	330.85	660.70	44.03	5184.58
11. STD OIL-CAL	PW	NYSE	16822.10	772.51	632.24	38.80	12898.20
12. ATLANTC RIC	CL	NYSE	7307.85	350.39	545.96	28.10	7364.78
13. EASTMN KODK	PW	NYSE	4958.53	613.69	493.00	124.00	5056.23
14. REYNLDS R J	EE	NYSE	4837.64	338.67	478.57	34.67	3294.32
15. DOW CHEMICL	HS	NYSE	4888.11	615.66	475.30	53.10	5846.73
16. GETTY OIL	AA	NYSE	2983.58	256.69	451.23	11.69	3239.86
17. OCCID PETE	AA	NYSE	5345.94	174.61	441.37	32.94	3503.37
18. PHILLIP PET	AY	NYSE	5133.55	342.57	409.45	30.51	4544.92
19. GEN TEL & EL	AA	NYSE	5948.39	388.16	390.09	187.00	12713.70
20. SUN OIL CO	CL	NYSE	4389.12	220.05	386.35	27.85	4383.51
21. SHELL OIL	PW	NYSE	8143.45	514.83	379.12	32.50	7010.75
22. GEN ELECTRIC	PMM	NYSE	13399.10	580.80	358.00	375.00	9763.50
23. XEROX CORP	PMM	NYSE	4053.76	341.63	342.60	93.53	4455.64
24. MARATHN OIL	EE	NYSE	2878.17	128.12	338.71	11.87	2005.42
25. INTL TEL & TL	AA	NYSE	11367.50	398.17	333.24	376.00	10407.90
26. SEARS ROE	TR	NYSE	13101.20	511.39	304.20	437.00	11339.40
27. PROCTR & GM	HS	NYSE	6081.67	333.86	287.77	51.00	3652.67
28. U S STEEL	PW	NYSE	8167.20	559.60	264.00	172.80	8148.20
29. CITICORP	PMM	NYSE	4936.57	348.20	263.19	44.60	57849.71
30. PAC TEL & TEL	CL	NYSE	3289.77	310.95	256.47	94.72	8249.98
31. TENNECO INC	AA	NYSE	5630.33	342.94	256.15	78.38	6584.20
32. CATERPILLAR	PW	NYSE	4963.69	398.70	248.80	78.29	3386.60
33. IMPRL OIL	PW	AMEX	4047.00	250.00	240.00	15.32	2950.00
34. AM HOME PRD	AA	NYSE	2258.64	250.69	238.18	46.39	1390.71
35. UNION O-CAL	CL	NYSE	5086.42	232.75	238.10	15.67	3776.12
36. MONSANTO CO	HS	NYSE	3624.70	306.30	230.00	59.24	3450.90
37. MATSUSHITA EL IND CO	PMM	NYSE	4885.41	180.50	229.71	88.18	4192.07
38. COCA-CL CO	EE	NYSE	2872.84	239.31	220.91	0.0	1710.87
39. CDN PAC LTD	PW	NYSE	3112.85	181.28	197.43	0.0	5434.52
40. KRESGE S S	PW	NYSE	6883.61	200.83	197.30	0.0	2377.54
41. AMERADA HES	AY	NYSE	3179.57	128.40	196.07	6.15	2385.46
42. MINN MIN&MF	HS	NYSE	3127.34	261.62	195.00	78.43	3016.76
43. MINN MIN&MF	CL	NYSE	3127.34	261.62	195.00	78.43	3016.76
44. UNILEVER NV	PW	NYSE	7891.94	207.41	188.15	0.0	4169.04
45. SOUTHN CO	AA	NYSE	1998.91	278.77	187.64	0.0	7237.00
46. HALLIBURTON	AA	NYSE	4209.60	222.51	181.32	85.25	2092.07
47. DUPONT (EI)	PW	NYSE	7221.50	271.80	176.50	132.24	6425.00
48. MORGAN JP	HS	NYSE	1960.94	191.89	163.51	9.81	25832.41
49. AM BRANDS	CL	NYSE	2569.70	140.03	162.49	0.0	2409.39
50. PENNY J C	PMM	NYSE	7678.60	189.60	161.60	186.00	3226.00
		TOTALS	444748.02	26816.42	35513.14	4638.69	508900.38

* Sales, net income, taxes, assets are in billion dollars. Employees are in thousands.

Note: A blank field in the original data is denoted by 0.0 to distinguish it from a legitimate value of zero which is denoted by 0.00.

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Table 5

BIG EIGHT ACCOUNTING FIRMS:
FIFTY LARGEST CLIENTS RANKED BY EMPLOYEES*
1974 - 1975

CLIENT NAME	LIST	EXCH	SALES	NET INCOME	TAXES	EMPLOYEES	ASSETS
1. GEN MOTORS	HS	NYSE	35724.91	1253.09	1118.20	681.00	21664.91
2. SEARS ROE	TR	NYSE	13101.20	511.39	304.20	437.00	11339.40
3. FORD MOTOR	CL	NYSE	24009.10	227.50	151.90	416.12	14020.20
4. INTL TEL & TL	AA	NYSE	11367.50	398.17	333.24	376.00	10407.90
5. GEN ELECTRC	PMM	NYSE	13399.10	580.80	358.00	375.00	9763.50
6. INTL BUS MA	PW	NYSE	14436.50	1989.88	1731.00	288.65	15530.50
7. CHRYSLER CP	TR	NYSE	11598.40	-207.21	26.40	217.59	6266.73
8. GEN TEL & EL	AA	NYSE	5948.39	388.16	390.09	187.00	12713.70
9. PENNEY J C	PMM	NYSE	7678.60	189.60	161.60	186.00	3226.00
10. U S STEEL	PW	NYSE	8167.20	559.60	264.00	172.80	8148.20
11. WESTNGHS EL	PW	NYSE	5862.74	178.62	93.84	166.05	4866.28
12. GOODYR TIRE	PW	NYSE	5452.47	161.61	155.25	148.23	4173.67
13. UTD TECH CP	PW	NYSE	3877.77	117.49	111.47	138.07	2701.31
14. EXXON CORP	PW	NYSE	44865.01	2503.00	7279.00	137.00	32839.41
15. DUPONT (EI)	PW	NYSE	7221.50	271.80	176.50	132.24	6425.00
16. SAFEWAY STR	PMM	NYSE	9716.89	148.63	126.50	126.96	1574.67
17. EASTMN KODK	PW	NYSE	4958.53	613.69	493.00	124.00	5056.23
18. ROCKWEL INT	HS	NYSE	4943.40	101.60	73.70	122.79	2888.10
19. MARCOR	AA	NYSE	4667.48	120.38	105.66	120.90	3169.02
20. BETHLHM STL	PW	NYSE	4977.20	242.00	41.00	113.00	4591.50
21. RCA CORP	AY	NYSE	4789.50	110.00	78.60	113.00	3728.40
22. SINGER CO	PMM	NYSE	2587.00	29.00	1.00	111.00	2016.10
23. FIRESTN TIR	CL	NYSE	3724.15	134.30	94.70	111.00	3180.80
24. COURTAULDS	PW	AMEX	2730.43	214.55	70.56	110.93	2666.14
25. GRT A&P TEA	HS	NYSE	6874.61	-157.07	-11.20	105.00	1020.71
26. INTL HARVST	HS	NYSE	5246.04	115.92	59.73	104.17	3510.34
27. GULF & WSTRN	EE	NYSE	2602.15	140.06	46.00	100.00	3305.70
28. ROYAL D PET	PW	NYSE	19795.30	1626.93	3862.64	98.40	18140.80
29. LITTON INDS	TR	NYSE	3430.17	35.28	32.37	97.00	2185.73
30. PAC TEL & TEL	CL	NYSE	3289.77	310.95	256.47	94.72	8249.98
31. XEROX CORP	PMM	NYSE	4053.76	341.63	342.60	93.53	4455.64
32. SPERRY RAND	AY	NYSE	3040.86	131.42	111.80	92.96	2533.12
33. FEDT DEPT	TR	NYSE	3269.11	119.01	119.00	89.22	1613.92
34. MATSUSHITA ELEC IND	PMM	NYSE	4885.41	180.50	229.71	88.18	4192.07
35. HALLIBURTON	AA	NYSE	4209.60	222.51	181.32	85.25	2092.07
36. HONEYWELL	HS	NYSE	2760.07	76.48	44.15	83.05	2573.91
37. TRW INC	EE	NYSE	2585.68	103.90	80.41	82.76	1686.46
38. PENN CENTRAL TRANS CO	HS	NYSE	2247.26	-198.02	0.0	78.75	4271.43
39. TRANS WORLD	HS	NYSE	2640.12	-86.28	-17.18	78.60	1929.45
40. MINN MIN&MF	HS	NYSE	3127.34	261.62	195.00	78.43	3016.76
41. MINN MIN&MF	CL	NYSE	3127.34	261.62	195.00	78.43	3016.76
42. TENNECO INC	AA	NYSE	5630.33	342.94	256.15	78.38	6584.20
43. CATERPILLAR	PW	NYSE	4963.69	398.70	248.80	78.29	3386.60
44. CONS FOODS	AA	NYSE	2443.03	50.61	50.79	78.00	1036.81
45. TEXACO INC	AA	NYSE	24507.50	830.58	982.05	75.24	17262.40
46. BENDIX CORP	HS	NYSE	2589.70	79.80	48.30	74.10	1567.60
47. BOEING CO	TR	NYSE	3718.85	76.35	36.40	72.60	1788.90
48. DEL MONTE	PW	NYSE	1279.27	47.25	25.11	72.00	777.96
49. NCR CORP	PW	NYSE	2165.61	65.94	53.90	72.00	2194.72
50. BURLINGTN IN	PMM	NYSE	1958.09	39.77	34.90	71.00	1566.52
		TOTALS	382245.63	16256.05	21203.63	7312.39	296918.23

* Sales, net income, taxes, assets are in billion dollars. Employees are in thousands.

Note: A blank field in the original data is denoted by 0.0 to distinguish it from a legitimate value of zero which is denoted by 0.00.

Table 6

BIG EIGHT ACCOUNTING FIRMS:
FIFTY LARGEST CLIENTS RANKED BY ASSETS*
1974 - 1975

CLIENT NAME	LIST	EXCH	SALES	NET INCOME	TAXES	EMPLOYEES	ASSETS
1. AM TEL & TEL	CL	NYSE	28957.21	3147.72	2390.24	0.0	80156.18
2. CITICORP	PMM	NYSE	4936.57	348.20	263.19	44.60	57849.71
3. CHASE MAN	PMM	NYSE	3231.69	156.64	70.35	30.12	41413.61
4. EXXON CORP	PW	NYSE	44865.01	2503.00	7279.00	137.00	32839.41
5. MFRS HAN	HS	NYSE	1857.69	136.38	99.78	17.69	28290.51
6. MORGAN JP	HS	NYSE	1960.94	191.89	163.51	9.81	25832.41
7. CHEM NY CP	PW	NYSE	1796.76	98.64	36.05	15.75	23771.30
8. GEN MOTORS	HS	NYSE	35724.91	1253.09	1118.20	681.00	21664.91
9. BANKERS TR	PW	NYSE	1494.69	63.80	20.09	12.91	20611.41
10. CONT ILL	EE	NYSE	1441.24	119.00	76.16	9.93	20225.30
11. FST CHICAGO	AA	NYSE	1447.01	105.52	44.16	7.86	19012.00
12. WESTN BANCP	EE	NYSE	1497.74	84.67	32.50	25.85	18727.10
13. ROYAL D PET	PW	NYSE	19795.30	1626.93	3862.64	98.40	18140.80
14. TEXACO INC	AA	NYSE	24507.50	830.58	982.05	75.24	17262.40
15. INTL BUS MA	PW	NYSE	14436.50	1989.88	1731.00	288.65	15530.50
16. AETNA LIFE	PMM	NYSE	6072.33	101.66	2.52	0.0	15464.40
17. MOBIL OIL	AY	NYSE	20620.41	809.88	2363.15	0.0	15050.30
18. FORD MOTOR	CL	NYSE	24009.10	227.50	151.90	416.12	14020.20
19. STD OIL-CAL	PW	NYSE	16822.10	772.51	632.24	38.80	12898.20
20. GEN TEL & EL	AA	NYSE	5948.39	388.16	390.09	187.00	12713.70
21. GULF OIL CP	PW	NYSE	14268.00	700.00	2012.00	52.10	12425.00
22. WELLS FARGO	PMM	NYSE	937.91	56.15	34.66	12.14	12362.20
23. SEARS ROE	TR	NYSE	13101.20	511.39	304.20	437.00	11339.40
24. CHARTER NY	PMM	NYSE	708.96	45.09	19.87	7.60	11106.60
25. MARINE MIDL	PW	NYSE	851.03	16.44	-0.68	11.01	11104.10
26. CROCKER NAT	AA	NYSE	798.14	39.88	18.87	10.86	10449.10
27. INTL TEL & TL	AA	NYSE	11367.50	398.17	333.24	376.00	10407.90
28. STD OIL-IND	PW	NYSE	9955.25	786.99	1179.44	46.81	9854.09
29. TRAVELERS	CL	NYSE	4569.00	127.80	6.80	0.0	9841.50
30. GEN ELECTRC	PMM	NYSE	13399.10	580.80	358.00	375.00	9763.50
31. FST NAT BOS	CL	NYSE	726.92	42.47	19.79	9.10	8614.10
32. PAC TEL & TEL	CL	NYSE	3289.77	310.95	256.47	94.72	8249.98
33. US STEEL	PW	NYSE	8167.20	559.60	264.00	172.80	8148.20
34. NOWST BANCP	PMM	NYSE	540.28	58.30	20.57	0.0	7386.97
35. ATLANTC RIC	CL	NYSE	7307.85	350.39	545.96	28.10	7364.78
36. NATL DETROIT	TR	NYSE	490.17	53.62	17.73	5.51	7347.22
37. SOUTHN CO	AA	NYSE	1998.91	278.77	187.64	0.0	7237.00
38. FST PENN CP	PMM	NYSE	552.12	18.27	-17.85	6.94	7066.81
39. SHELL OIL	PW	NYSE	8143.45	514.83	379.12	32.50	7010.75
40. PAC G & E	HS	NYSE	2233.37	251.58	-.91	24.99	6620.88
41. TENNECO INC	AA	NYSE	5630.33	342.94	256.15	78.38	6584.20
42. AHMANSON HF	PMM	NYSE	561.99	43.61	22.60	0.0	6496.56
43. DUPONT (EI)	PW	NYSE	7221.50	271.80	176.50	132.24	6425.00
44. AM ELEC PWR	HS	NYSE	1644.22	239.76	14.89	18.39	6408.28
45. FST INTL BN	AA	NYSE	435.06	51.71	10.89	3.81	6356.37
46. CONS EDISON	PW	NYSE	2667.94	274.73	53.91	24.65	6315.41
47. CHRYSLER CP	TR	NYSE	11598.40	-207.21	26.40	217.59	6266.73
48. DOW CHEMICL	HS	NYSE	4888.11	615.66	475.30	53.10	5846.73
49. CMNWLTH ED	AA	NYSE	1722.33	206.91	151.54	0.0	5688.14
50. CON PAC LTD	PW	NYSE	3112.85	181.28	197.43	0.0	5434.52
		TOTALS	404311.95	22678.33	29039.17	4328.07	756996.37

* Sales, net income, taxes, assets are in billion dollars. Employees are in thousands.

Note: A blank field in the original data is denoted by 0.0 to distinguish it from a legitimate value of zero which is denoted by 0.00.

CPA Firms in Selected Industries

Using Standard & Poor's Industry Surveys, an attempt was made to determine the ten largest companies (at least ten of the largest companies) in six selected industries. No attempt was made to determine the criteria by which Standard & Poor's grouped the companies into various industries, but that they used some reasonable basis was accepted. The six broadly defined industries are: (1) Natural Resources (Fuel), (2) Banks and Bank Holding Companies, (3) Chemicals, (4) Drugs and Pharmaceuticals, (5) General Machinery and Equipment, and (6) Electric Power Companies and Holding Companies.

Tables 7 - 9 show the ten largest companies in the six selected industries, the CPA firms which are associated with them, and the sales and assets attributable to each company. The most striking observation in these tables is that six out of the top ten natural resource companies are clients of Price Waterhouse & Co. Furthermore, these six companies account for 1/3 of the sales of all the clients of Price Waterhouse & Co. Finally it seems that a determining factor in the observed "preeminence" of this CPA firm has been established.

That Price Waterhouse & Co. is the most prominent firm in this service industry conforms with the findings of the other sections of this report. None of the other five industries have the same situation that is present in the natural resources industry. Four of the ten companies in the general machinery and equipment

industry are clients of PW, but there are also two companies which are not clients of any of the big eight firms. In the electric power companies' and holding companies' category, two firms--Arthur Andersen & Co. and Haskins and Sells--each have four clients. None of these other five industries suggest that the situation in the natural resources industry (i.e. the dominance of a single CPA firm) is the normal course of events in the public accounting profession.

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Table 7

Big Eight Accounting Firms
Top Ten Companies in Selected Industries
1974-1975

Industries - Company Names	Accounting Firm	Sales or Revenues	Total Assets
		(billion dollars)	
Natural Resources (Fuel)			
Exxon Corp.	PW	44,865.01	32,839.41
Royal Dutch Petroleum	PW	19,795.30	18,140.80
Standard Oil - California	PW	16,822.10	12,898.20
Gulf Oil Corp.	PW	14,268.00	12,425.00
Standard Oil - Indiana	PW	9,955.25	9,854.09
Shell Oil	PW	8,143.45	7,010.75
	Subtotals	113,849.11	93,168.25
Mobil Oil	AY	20,620.41	15,050.30
Continental Oil Company	AY	7,253.80	5,184.58
	Subtotals	27,874.21	20,234.88
Texaco, Inc.	AA	24,507.50	17,262.40
Atlantic Richfield	CL	7,307.85	7,364.78
	Totals	173,538.67	138,030.31
Banks and Bank Holding Companies			
Citicorp.	PMM	4,936.57	57,849.71
Chase Manhattan	PMM	3,231.69	41,413.61
Wells Fargo	PMM	937.91	12,362.20
	Subtotals	9,106.71	111,625.52
Manufacturers Hanover	HS	1,857.69	28,290.51
J.P. Morgan	HS	1,960.94	25,832.41
	Subtotals	3,818.63	54,122.92
Chemical New York Corp.	PW	1,796.76	23,771.30
Bankers Trust	PW	1,494.69	20,611.41
	Subtotals	3,291.45	44,382.71
Continental Illinois	EE	1,441.24	20,225.30
Western Bankcorporation	EE	1,497.74	18,727.10
	Subtotals	2,938.98	38,952.40
First Chicago	AA	1,447.01	19,012.00
	Totals	20,602.78	268,095.55

Table 8

Big Eight Accounting Firms
Top Ten Companies in Selected Industries
1974-1975

Industries - Company Names	Accounting Firms	Sales or Revenues	Total Assets
		(billion dollars)	
Chemicals			
E.I. DuPont	PW	7,221.50	6,425.00
Allied Chemical	PW	2,333.11	2,235.91
W.R. Grace & Co.	PW	3,529.16	2,523.80
	Subtotals	13,083.77	11,184.71
FMC Corp.	PMM	2,291.93	1,843.87
Celanese Corp.	PMM	1,900.00	1,908.00
American Cyanamid	PMM	1,928.44	1,722.17
	Subtotals	6,120.37	5,474.04
Dow Chemical	HS	4,888.11	5,846.73
Monsanto Co.	HS	3,624.70	3,450.90
	Subtotals	8,512.81	9,297.63
Hercules, Inc.	CL	1,413.11	1,316.25
Union Carbide	Other	5,665.00	5,740.80
	Totals	34,795.06	33,013.43
Drugs and Pharmaceuticals			
American Home Products	AA	2,258.64	1,390.71
Merck & Co.	AA	1,489.66	1,573.69
Abbott Laboratories	AA	940.66	925.52
	Subtotals	4,688.96	3,889.92
Bristol-Myers	PW	1,827.67	1,183.34
Sterling Drugs	PW	957.15	736.39
Warner-Lambert	PW	2,172.27	1,808.25
	Subtotals	4,957.09	3,727.98
Squibb Corp.	PMM	1,111.03	1,169.02
Eli Lilly & Co.	EE	1,233.74	1,433.90
Upjohn Co.	CL	890.77	874.24
Pfizer, Inc.	Other	1,665.46	2,019.38
	Totals	14,547.05	13,114.44

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Table 9

Big Eight Accounting Firms
Top Ten Companies in Selected Industries
1974-1975

Industries - Company Names	Accounting Firms	Sales or Revenues	Total Assets
		(billion dollars)	
General Machinery & Equipment			
Caterpillar Tractor	PW	3,112.85	5,434.52
Ingersall-Rand Co.	PW	1,708.30	1,673.15
Babcock and Wilcox	PW	1,564.99	1,135.40
Clark Equipment Co.	PW	1,424.58	915.99
	Subtotals	7,810.72	9,159.06
AMF, Inc.	AY	1,004.70	779.47
Pullman Inc.	AY	2,006.98	886.45
	Subtotals	3,011.68	1,665.92
International Harvester	HS	5,246.04	3,510.34
U.S. Industries, Inc.	EE	1,566.68	1,049.04
Combustion Engine	AA	1,711.15	1,054.48
Foster-Wheeler	Other	1,020.87	441.02
	Totals	20,367.14	16,879.86
Electric Power Companies and Holding Companies			
Southern Company	AA	1,998.91	7,237.00
Commonwealth Edison	AA	1,722.33	5,688.14
Southern California Edison	AA	1,483.43	4,403.94
Consumers Power Co.	AA	1,341.10	3,361.13
	Subtotals	6,545.77	20,690.21
Pacific Gas & Electric Co.	HS	2,233.37	6,620.88
Public Service Elec. & Gas Co.	HS	1,630.52	4,473.47
American Elec. Power Co.	HS	1,644.22	6,408.28
Florida Power & Light	HS	1,182.64	3,416.94
	Subtotals	6,690.75	20,919.57
Consolidated Edison	PW	2,667.94	6,315.41
Detroit Edison Co.	PW	1,070.78	3,649.94
	Subtotals	3,738.72	9,965.35
	Totals	16,975.24	51,575.13

Summary

In response to the Subcommittee's request, CRS has provided published financial and employment data for the clients of the "big eight" CPA firms which are listed on the NYSE and the AMSE. These eight CPA firms provided lists of their clients on the NYSE and the AMSE in response to a questionnaire devised by the Subcommittee in December 1975. The five categories of financial and employment data are: (1) sales, (2) net income, (3) income taxes, (4) number of employees, and (5) total assets.

In Section II of this report these data have been totaled for each CPA firm and for all eight CPA firms. These totals have been related to various aggregate economic statistics. In Section III the number of companies on the NYSE and the AMSE claimed as clients by the "big eight" CPA firms are related to the total number of clients claimed by the eight CPA firms and then to the total number of companies listed on the respective exchanges in 1974. The five categories of financial and employment data noted above are similarly related to financial and employment data for the respective exchanges in Section IV. Section V gives the fifty largest clients of all eight CPA firms as ranked by the five categories of financial and employment data. Finally, Section VI relates the eight CPA firms to the largest companies in six selected industries.

ATTACHMENT 1--"BIG EIGHT" ACCOUNTING FIRMS: FINANCIAL AND EMPLOYMENT DATA

CLIENTS OF PRICE WATERHOUSE ON
NYSE AND AMEX

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
ACF INDS	NYSE	566.96	30.72	25.07	11.84	691.03
ADDRESOGRPH	NYSE	584.25	4.91	6.06	20.80	441.14
ALCAN ALUM	NYSE	2301.45	22.57	27.06	61.00	3011.78
ALLD CHEM	NYSE	2333.11	116.19	73.41	33.40	2235.91
ALLEG POWER	NYSE	653.92	81.31	53.24	0.00	1903.05
ALLIS-CHLMR	NYSE	1443.26	29.39	19.43	26.74	980.95
AM DIST TEL	NYSE	164.28	11.37	9.65	7.46	219.95
AMCORD INC	NYSE	166.17	7.10	2.03	0.00	212.06
AMERICAN WATER WORKS	NYSE	160.26	13.23	0.44	3.39	834.24
AMPCO-PITTS	NYSE	112.34	6.22	4.77	1.66	65.07
AMSTED INDS	NYSE	498.69	38.18	37.18	10.40	258.33
ANACONDA CO	NYSE	1087.78	-39.79	1.17	22.74	2007.45
ANCHOR HOCK	NYSE	493.56	21.70	17.22	17.00	325.08
ANSUL CO	NYSE	113.40	2.20	1.85	2.43	94.58
AVERY INTL	NYSE	282.61	5.02	5.32	5.98	229.90
BABCOCK &WL	NYSE	1564.99	42.32	40.66	40.98	1135.40
BALL CORP	NYSE	365.29	14.06	10.61	8.00	225.07
BANCAL CORP	NYSE	219.31	3.29	0.27	3.85	3083.70
BANKERS TR	NYSE	1494.69	63.80	20.09	12.91	0611.41
BALSCH-LOMB	NYSE	333.88	16.17	14.23	12.10	258.58
BAYUK CIGAR	NYSE	31.84	-1.87	-0.75	1.81	33.92

BECKMN INST	NYSE	228.64	9.84	5.62	7.30	216.83
BEMIS CO	NYSE	541.64	8.65	9.48	13.39	309.55
BETHLEM STL	NYSE	4977.20	242.00	41.00	113.00	4591.50
BORDEN INC	NYSE	3367.24	92.88	77.60	42.10	1656.47
BORMANS INC	NYSE	499.12	1.54	0.68	6.30	73.56
BRISTL-MYRS	NYSE	1827.67	141.70	112.21	29.20	1183.34
BURROUGH CP	NYSE	1675.65	164.41	127.20	51.67	2434.95
CAMPBL SOUP	NYSE	1545.55	86.97	83.55	30.95	844.16
CARBORUNDUM	NYSE	563.06	27.19	26.22	17.08	470.72
CARLG O'KEE	NYSE	317.04	-1.63	2.24	0.00	270.48
CARTER HAWL	NYSE	1121.79	32.44	28.20	53.00	671.74
CATERPILLAR	NYSE	4963.69	398.70	248.80	78.29	3386.60
CDN PAC LTD	NYSE	3112.85	181.28	197.43	0.00	5434.52
CENTL HUDSN	NYSE	158.31	14.34	4.45	1.41	376.14
CERRO CORP	NYSE	599.17	-2.41	8.20	8.00	720.70
CHEM NY CP	NYSE	1796.76	98.64	36.05	15.75	3771.30
CHI PNEU TL	NYSE	180.22	18.77	18.25	9.14	249.12
CHI,ROCK ISL.& PAC. RR	NYSE	384.84	-23.10	33.04	10.00	424.61
CLARK EQUIP	NYSE	1424.58	46.62	29.95	25.78	915.99
CLEV EL ILM	NYSE	523.16	64.77	10.31	4.95	1513.25
COLECO INDS	NYSE	71.00	0.09	-0.01	0.00	57.86
COLMBIA PIC	NYSE	332.06	5.31	8.84	2.80	305.48
COMP COMMUN	NYSE	130.10	7.66	8.68	4.01	272.92
CONN GEN MG	NYSE	46.80	8.34	0.00	0.00	435.95
CONS EDISON	NYSE	2667.94	274.73	53.91	24.65	6315.41
CONS NAT GS	NYSE	970.56	72.90	35.82	7.71	1798.35
CONT CORP	NYSE	1798.17	91.87	-19.72	0.00	4079.26
COOPER INDS	NYSE	473.19	31.13	28.78	11.26	369.20

CLIENTS OF PRICE WATERHOUSE ON
NYSE AND AMEX--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
CORNING GLS	NYSE	938.96	31.14	7.72	33.50	921.45
CROWN CORK	NYSE	825.01	41.61	34.93	15.63	538.95
CYCLOPS CP	NYSE	483.56	-6.84	-14.16	7.50	303.99
DANA CORP	NYSE	1136.45	62.17	53.90	20.60	822.18
DART INDS	NYSE	1280.41	78.99	77.50	28.61	1190.69
DATA GENL	NYSE	108.22	12.85	11.88	3.28	116.47
DEL MONTE	NYSE	1279.27	47.25	25.11	72.00	777.96
DELTEC INTL	NYSE	21.56	0.39	-0.09	0.90	168.08
DENTSPLY	NYSE	103.47	8.39	6.18	4.00	74.22
DET EDISON	NYSE	1070.78	98.45	34.54	9.57	3649.94
DI GIORGIO	NYSE	613.47	0.64	0.73	0.00	221.73
DIAMND SHAM	NYSE	1129.35	114.27	74.58	10.26	1181.59
DISNEY WALT	NYSE	520.01	61.74	54.00	14.50	782.67
DIVERFD MTG	NYSE	24.69	-36.82	0.00	0.00	330.77
DORR-OLIVER	NYSE	141.93	6.12	7.08	2.95	107.02
DUPONT (EI)	NYSE	7221.50	271.80	176.50	132.24	6425.00
EASCO CORP	NYSE	203.33	7.11	7.35	5.22	97.30
EASTMN KODK	NYSE	4958.53	613.69	493.00	124.00	5056.23
EASTN AIRL	NYSE	1530.29	7.90	2.50	32.60	1410.72
ECHLIN MFG	NYSE	162.06	7.95	7.37	4.80	120.94
ELGIN NATL*	NYSE	73.61	0.88	1.03	1.20	60.84
ELTRA CORP	NYSE	766.59	36.54	27.19	23.51	535.12

EMERY AIR	NYSE	244.20	12.60	11.37	2.80	73.92
EQUIMARK CP	NYSE	208.32	8.13	-2.16	0.00	2348.63
EXXON CORP	NYSE	4865.01	2503.00	7279.00	137.00	2839.41
FAIRCHLD CM	NYSE	291.54	10.42	6.71	17.41	300.64
FANSTEEL	NYSE	87.27	1.39	0.83	2.20	62.31
FIBREBOARD	NYSE	262.85	-6.01	-5.79	6.00	247.86
FISHR SCIEN	NYSE	199.42	5.60	6.24	3.40	100.99
FRANKLN MNT	NYSE	233.91	19.15	20.40	2.51	138.32
GEN CIGAR	NYSE	288.85	5.72	1.14	6.99	217.91
GEN FOODS	NYSE	3675.09	120.79	119.90	46.00	1396.55
GEN HOST	NYSE	667.58	4.04	2.50	11.24	205.68
GEN STEEL	NYSE	59.23	2.41	2.67	1.30	51.89
GEN TIRE-RB	NYSE	1751.96	62.37	37.26	39.00	1427.30
GOODYR TIRE	NYSE	5452.47	161.61	155.25	148.23	4173.67
GRACE W R	NYSE	3529.16	166.68	137.50	60.20	2523.80
GRAND UNION	NYSE	1562.74	9.50	8.80	22.00	335.81
GRT WST FIN	NYSE	400.36	22.88	14.90	1.60	5365.06
GULF OIL CP	NYSE	4268.00	700.00	2012.00	52.10	2425.00
HACKENSACK WATER CO.	NYSE	32.03	2.88	-0.33	0.54	154.38
HALL W F	NYSE	123.09	4.68	3.86	4.00	38.36
HAMMERMILL	NYSE	535.36	16.38	10.69	0.00	440.66
HARNISCHFGR	NYSE	376.90	23.47	19.20	8.20	319.49
HART SCHFNR	NYSE	486.83	8.31	8.01	19.50	238.80
HOERNER-WLD	NYSE	441.16	28.25	17.63	8.30	348.37
HOWARD JOHN	NYSE	417.51	24.33	22.14	24.70	247.20
HUYCK CORP	NYSE	77.33	3.69	3.88	3.28	96.17
HYDROMETALS	NYSE	96.55	5.37	2.93	2.15	61.25

CLIENTS OF PRICE WATERHOUSE ON
NYSE AND AMEX--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
ILL POWER	NYSE	408.95	56.72	39.46	0.00	1270.26
INGERSL-RND	NYSE	1708.30	119.18	81.60	45.30	1673.15
INLAND CONT	NYSE	335.17	29.47	16.78	4.58	258.98
INLND STEEL	NYSE	2107.42	83.35	43.56	32.64	1866.54
INMONT CORP	NYSE	451.55	11.65	14.02	8.50	306.43
INSILCO CP	NYSE	332.77	14.06	7.87	7.33	352.84
INSPIR CONS	NYSE	78.27	-3.91	-1.20	1.92	169.25
INTERLK INC	NYSE	640.83	39.71	29.47	10.50	480.11
INTERPACE	NYSE	295.94	11.14	8.36	0.00	219.03
INTERPUB CO	NYSE	153.65	6.96	8.48	6.40	168.02
INTL BUS MA	NYSE	4436.50	1989.88	1731.00	288.65	5530.50
INTL FLV&FR	NYSE	219.09	24.13	18.02	2.87	230.14
INTL MINING	NYSE	27.17	4.14	4.27	1.40	84.60
JEWELCOR	NYSE	80.02	0.05	1.83	1.02	57.35
JOHNSON CTL	NYSE	284.24	9.32	9.59	10.00	201.54
JORGNSN ERL	NYSE	223.82	14.29	13.41	0.00	122.59
JOY MFG CO	NYSE	555.30	38.50	33.18	12.47	425.03
KAN CITY SO	NYSE	160.07	4.94	0.91	0.00	289.51
KELLOGG CO	NYSE	1213.62	103.03	99.90	0.00	680.45
KIDDE WALTR*	NYSE	1155.88	43.18	38.22	35.00	854.89
KRESGE S S	NYSE	6883.61	200.83	197.30	0.00	2377.54
LEAR SIEGLR	NYSE	643.75	20.09	15.05	17.12	379.35

LEHIGH PORT	NYSE	122.39	3.03	-0.25	0.00	155.17
LEHMAN CORP.	NYSE	11.59	9.45	0.12	0.03	372.71
LIONEL CORP	NYSE	123.97	1.52	1.04	0.00	57.58
LONG ISLAND	NYSE	671.53	87.28	10.11	5.45	1902.62
LUCKY STORE	NYSE	2701.77	41.45	40.10	39.40	512.74
LYKES-YNGS	NYSE	1517.84	56.89	13.75	0.00	1630.45
M C A INC	NYSE	811.48	95.51	79.00	0.00	624.55
MARINE MIDL	NYSE	851.03	16.44	-0.68	11.01	1104.10
MATTEL INC	NYSE	329.31	2.01	4.12	0.00	178.69
MAYER OSCAR	NYSE	1054.64	26.95	23.80	12.13	309.86
MCINTYRE MIN	NYSE	95.74	11.51	6.03	0.85	217.71
MESTA MACH	NYSE	80.11	1.23	1.00	2.73	85.58
MICROWAVE	NYSE	54.75	2.16	2.11	1.89	36.91
MILES LABS	NYSE	413.76	13.08	6.00	8.45	345.75
MINN P&L	NYSE	96.21	8.98	6.12	1.25	297.53
MISS RIVER	NYSE	1113.79	49.28	34.37	0.00	1631.94
MOBILE HOME*	NYSE	60.16	-6.36	-0.78	1.18	60.39
MONROE AUTO	NYSE	151.33	6.68	8.83	4.69	182.46
MONT PWR CO	NYSE	145.13	30.95	5.67	1.60	669.22
NARCO SCIEN	NYSE	63.35	2.39	1.76	1.60	40.59
NASHUA CORP	NYSE	304.89	1.42	2.27	6.25	214.81
NATL CHMSRC	NYSE	173.34	17.21	16.27	4.55	117.10
NATL DISTLR	NYSE	928.39	72.95	60.02	13.59	1024.20
NATL FUEL	NYSE	352.19	16.52	2.70	0.00	448.00
NATL HOME	NYSE	99.08	-14.48	0.31	3.80	142.95
NCR CORP	NYSE	2165.61	65.94	53.90	72.00	2194.72
NEWHAL LAND	NYSE	81.40	7.24	6.16	2.40	124.43

CLIENTS OF PRICE WATERHOUSE ON
NYSE AND AMEX--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
NIAGRA MCHW	NYSE	972.21	114.80	11.80	8.90	2652.62
NWSTN MUTL	NYSE	25.54	6.12	0.00	0.00	269.15
PAPERCRAFT	NYSE	78.27	5.93	6.90	0.00	80.34
PERKIN ELMR	NYSE	297.43	19.05	14.48	8.53	240.65
PET INC	NYSE	1008.51	23.16	21.95	17.70	477.44
PHELPS DODG	NYSE	780.79	46.39	-13.20	13.90	1652.14
PIER I	NYSE	97.10	1.02	2.07	3.60	51.98
PITNEY-BOW	NYSE	460.90	25.95	21.41	17.25	404.60
PORTEC INC	NYSE	107.52	5.46	4.01	1.95	56.44
POTOMAC EL	NYSE	492.51	55.13	-2.75	4.37	1778.87
PRDS RESRCH	NYSE	32.29	0.75	0.91	0.60	29.83
PUBLICKER	NYSE	183.04	6.18	4.10	0.00	145.60
PUREX CORP	NYSE	447.34	18.89	18.60	7.50	263.87
RALSTON PUR	NYSE	3149.10	99.50	87.50	55.00	1377.30
RAYMND INTL	NYSE	263.46	8.38	8.38	0.00	129.08
RICHRDSN MR	NYSE	658.69	44.62	38.66	15.00	620.81
ROCH G&E	NYSE	234.04	20.54	1.15	2.75	593.24
ROCHSTR TEL	NYSE	109.06	12.43	0.69	2.97	340.90
ROLLINS INC	NYSE	213.34	19.09	16.04	10.05	145.23
ROYAL D PET	NYSE	9795.30	1626.93	3862.64	98.40	8140.80
ROYAL INDS	NYSE	248.18	5.60	5.50	0.00	150.90
SAGA CORP	NYSE	353.38	4.30	3.94	37.00	75.43

SANDERS ASC	NYSE	180.30	1.53	0.56	6.00	92.45
SANTA F IND	NYSE	1432.16	109.19	40.90	36.80	2844.11
SANTA F INT	NYSE	331.79	28.71	13.50	7.58	488.52
SCHAEFER FM	NYSE	233.95	-34.87	-0.41	3.23	165.26
SCHLUMBERGR	NYSE	1565.57	219.34	125.39	0.00	1715.67
SCOT PAP CO	NYSE	1191.88	64.81	33.76	20.10	1284.67
SEAGRAM LTD	NYSE	977.43	74.12	39.54	17.00	1991.31
SEAGRAVE CP	NYSE	91.38	0.90	0.32	2.32	57.47
SEATRAIN LN	NYSE	439.48	-3.65	-0.50	2.25	394.97
SERVOMATION	NYSE	372.59	7.06	4.78	13.50	154.00
SHELL OIL	NYSE	8143.45	514.83	379.12	32.50	7010.75
SIMPLICITY	NYSE	89.56	8.03	7.72	4.00	120.22
SONY CORP	NYSE	1338.59	53.31	73.03	22.11	1379.15
SOUTHDOWN	NYSE	291.48	10.16	3.80	0.00	267.98
SOUTHN RY	NYSE	863.69	78.33	41.31	20.28	2111.82
ST LOUIS-SF	NYSE	280.35	5.12	1.60	8.44	541.15
ST MUTL INV	NYSE	15.83	-26.98	0.00	0.00	143.31
STD OIL-CAL	NYSE	6822.10	772.51	632.24	38.80	2898.20
STD OIL-IND	NYSE	9955.25	786.99	1179.44	46.81	9854.09
STERLG DRUG	NYSE	957.15	82.10	66.28	26.72	736.39
SUNBEAM CP	NYSE	852.73	23.07	24.89	25.10	606.95
SW FOREST	NYSE	442.91	2.00	-9.20	8.50	400.72
SYBRON CORP	NYSE	557.74	25.39	19.30	0.00	444.52
TANDY CORP	NYSE	724.49	36.42	36.30	16.00	414.61
TECHNICON	NYSE	202.09	20.59	6.28	3.50	241.86
TEXAS INTL	NYSE	45.21	7.56	0.87	1.45	107.53
THOMPSON CP	NYSE	134.62	3.01	3.31	5.41	174.88

CLIENTS OF PRICE WATERHOUSE ON
NYSE AND AMEX--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
TI CORP	NYSE	168.40	4.40	-1.46	0.00	281.68
TOOTSIE ROL	NYSE	46.84	0.77	0.63	0.00	25.15
TRANE CO	NYSE	388.71	9.65	7.04	10.90	331.27
TRI-SO MTG	NYSE	25.66	-10.68	0.00	0.00	218.85
TYCO LAB	NYSE	57.59	4.67	3.85	1.31	64.31
U S STEEL	NYSE	8167.20	559.60	264.00	172.80	8148.20
UNILEVER NV	NYSE	7891.94	207.41	188.15	0.00	4169.04
UNION ELEC	NYSE	583.45	86.43	26.94	0.00	2162.31
UTD BRANDS	NYSE	2186.52	10.07	17.30	48.00	1088.70
UTD FIN CA	NYSE	116.18	8.02	4.06	0.62	1502.78
UTD PFK CTY	NYSE	0.34	-0.07	0.02	0.00	18.11
UTD TECH CP	NYSE	3877.77	117.49	111.47	138.07	2701.31
WALKER (HR)	NYSE	509.10	50.65	48.64	7.90	913.17
WALTR JIM	NYSE	1237.25	69.96	50.68	23.10	1309.17
WARD FOODS	NYSE	467.07	2.32	2.22	8.70	145.83
WARNACO	NYSE	337.94	0.36	2.23	13.03	218.47
WARNR LAMB	NYSE	2172.27	163.90	125.58	57.50	1808.25
WESTN CO NA	NYSE	99.65	19.09	5.54	1.94	127.37
WESTN UNION	NYSE	569.27	32.05	-0.84	13.94	1512.61
WESTNGHS EL	NYSE	5862.74	178.62	93.84	166.05	4866.28
WESTVACO	NYSE	797.45	39.09	26.73	15.14	719.50
WHEEL-PITTS	NYSE	826.73	0.56	-0.10	10.88	675.54

WISC FL PWR	NYSE	431.58	46.92	41.40	5.76	1136.31
WOOLWRTH FW	NYSE	4650.29	99.52	77.95	0.00	2173.08
YOUNGTWN ST	NYSE	42.90	1.04	1.01	0.66	37.92
ALASKA AIRL	AMSE	51.20	1.46	1.35	0.00	37.31
ALLD ARTIST	"	39.24	-0.20	-0.32	0.46	20.31
ALLD THERML	"	50.94	2.38	2.48	0.00	38.48
ANGLO CO. LTD	"	40.23	1.76	1.86	0.35	46.02
AVC CORP	"	83.33	5.41	4.53	1.69	58.54
AYDIN CORP*	"	32.57	1.65	1.31	0.95	16.08
B T U ENG	"	9.66	0.18	0.24	0.20	6.54
BELL INDS	"	68.62	1.62	1.71	0.95	32.00
BERNZ-O-MAT	"	19.33	-1.54	0.00	0.38	17.75
BOW VALLEY	"	92.30	2.80	3.71	1.90	101.44
BRAUN ENG	"	26.40	1.00	0.60	0.32	19.80
BUEHLER CP	"	20.84	0.38	0.33	0.69	15.80
CALIF COMPT	"	121.90	-12.39	-0.92	3.25	104.21
CARNATION	"	2075.32	88.54	86.78	0.00	1003.70
CDN MARCONI	"	48.76	3.35	2.50	0.00	56.07
CDN MERRILL	"	11.91	0.44	0.48	0.00	29.45
CDN SUPRIOR	"	120.61	34.36	32.04	0.42	238.28
CHAMPN HOME	"	221.74	-9.00	-8.94	3.90	94.17
CHIEFTN DEV	"	19.57	1.24	1.40	0.30	37.90
CONNLY CONT	"	39.87	1.31	1.26	0.71	14.33
CONSYNE CP	"	15.04	1.26	1.25	0.58	12.10
COOK INDS	"	511.10	28.87	4.95	6.20	641.47
COURTAULDS	"	2730.43	214.55	70.56	110.93	2666.14
CROWN INDS	"	17.42	0.77	0.66	0.33	10.66

CLIENTS OF PRICE WATERHOUSE ON
NYSE AND AMEX--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
DANIEL INDS	AMSE	60.66	4.43	3.38	0.00	44.45
DIVERSEY CP	"	108.66	3.98	4.44	3.47	55.94
ELEC HOSE	"	52.47	0.87	0.44	1.24	32.92
FABRICS NAT	"	18.22	0.11	0.13	0.45	7.73
FILM CP AM	"	49.58	-2.67	-1.18	1.40	33.03
FLGHTSAFETY	"	11.20	2.13	2.54	0.20	15.20
FLOWER INDS	"	148.75	4.38	4.27	4.50	63.29
FRANKS NURS	"	45.55	1.46	1.47	1.50	21.00
GEN HOUSWR	"	56.21	-7.27	0.25	1.50	33.69
GLASROCK PD*	"	12.81	0.27	0.27	0.46	13.18
HANOVER PETROLEUM CORP.	"	10.55	1.64	0.47	0.05	35.55
HARTZ MTN	"	180.36	16.89	17.39	0.00	128.25
HILLHAVEN	"	78.12	1.05	0.95	6.35	55.81
HUBBELL HAR	"	172.03	14.44	12.84	5.31	124.15
IMPRL OIL	"	4047.00	250.00	240.00	15.32	2950.00
INTERWAY CP	"	76.50	-3.89	-0.85	0.00	215.59
INTL SEAWAY	"	23.61	-0.95	-0.86	0.09	17.18
IROQUOIS BD	"	45.22	-0.74	1.09	0.55	30.39
IRVIN INDS	"	57.85	0.77	0.78	1.50	34.69
JAMESWAY CP	"	98.69	0.80	0.58	2.39	30.91
JETRONIC	"	22.52	0.52	0.58	0.50	20.61
JUPITER IND	"	148.93	1.34	1.22	3.00	93.16

KINGSTP IND	AMSE	34.31	1.51	0.98	1.04	27.03
KLEFR-VU	"	9.12	0.14	0.17	0.35	4.43
LANDMK LAND*	"	8.81	-0.71	0.00	0.00	21.73
LEATH & CO	"	33.50	1.01	0.94	0.67	30.76
MANGOOD CP	"	23.07	0.20	0.06	0.00	12.20
METROCARE	"	32.36	0.44	0.36	0.78	45.93
MICH SUGAR	"	83.53	10.57	11.01	1.43	41.65
MICKELBERRY CORP.	"	30.83	0.94	1.09	0.48	13.36
MIDWEST RUB. RECLAIM. CO.	"	24.15	0.79	0.73	0.30	15.63
MILTON ROY	"	45.74	1.89	1.49	1.32	34.26
MO PAC RR	"	888.55	46.72	19.83	21.24	1672.06
NATL ALFALF	"	25.61	1.76	1.24	0.00	29.50
NEW IDRIA	"	21.38	0.21	0.38	0.46	14.45
PAN OCEAN	"	9.53	0.60	1.27	0.07	93.01
PARSONS R M	"	832.42	10.37	10.70	5.90	169.85
PATO CONS	"	0.00	1.73	0.09	0.00	29.55
PEPCOM INDS	"	40.92	1.68	1.69	0.79	23.47
PERMANEER*	"	49.55	-15.72	-1.23	1.80	55.59
PHOENIX STL	"	115.96	-3.37	0.00	0.00	103.24
PITTWAY CP	"	126.12	13.58	11.75	2.50	101.69
PLACER DEVE	"	110.39	9.77	6.49	2.79	253.42
PLYMOUTH RB	"	38.72	-1.73	-0.20	0.90	21.62
RATH PACKNG	"	399.36	-6.07	0.00	4.00	52.84
REMNGTN ARM	"	194.99	13.07	11.42	5.06	144.38
RESORT INTL	"	45.07	2.92	1.76	1.70	61.04
RIBLET PROD	"	39.24	-0.74	-0.47	0.76	25.78
RLC CORP	"	178.76	0.37	0.35	0.00	230.95

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CLIENTS OF PRICE WATERHOUSE ON
NYSE AND AMEX--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
RONCO TELPC	AMSE	22.19	0.57	0.62	0.08	11.26
RUSCO INDS	"	55.55	0.19	0.18	1.27	29.55
RUST CRAFT	"	81.59	3.13	2.97	4.00	83.34
SARGENT INC	"	58.52	1.49	1.25	1.55	37.39
SCURRY-RNBW	"	13.07	2.98	3.28	0.08	71.20
SIERRACIN	"	21.76	0.77	0.82	0.00	10.92
SOLITRON DV	"	29.42	-2.53	0.00	1.00	37.15
SOUNDESIGN	"	88.51	1.04	0.30	0.60	61.31
SPECTRO INC	"	95.95	1.16	1.34	0.70	36.75
STAR SUPRMK	"	197.69	1.86	1.85	2.24	27.46
SUPERCRETE	"	23.00	1.59	1.22	0.00	14.84
SUSQUEHANNA	"	124.72	-0.62	-0.07	3.21	96.68
TECH-SYM	"	13.41	0.20	0.17	0.39	18.51
TELEFLEX	"	32.50	0.39	0.38	0.00	25.91
TERRA CHEM	"	109.78	18.56	18.19	0.00	77.16
TOTAL PETRO	"	247.62	9.00	7.85	0.00	195.29
TWIN FAIR	"	169.05	2.06	1.61	4.62	83.82
UNITED NATIONAL CORP.	"	24.64	-2.64	-0.44	0.35	109.11
VIKING GEN	"	17.17	0.07	0.06	0.17	52.44
WASH POST	"	309.33	12.04	13.55	4.70	230.60
WOOD INDS	"	24.99	-0.48	-0.55	0.65	22.55
WORK WEAR	"	175.44	2.05	1.99	9.66	143.33

CLIENTS OF ARTHUR ANDERSEN & CO.

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
A T O INC	NYSE	480.48	12.19	11.42	16.48	299.80
ABBOTT LABS	NYSE	940.66	70.67	31.75	23.70	925.52
AIR PRDS-CH	NYSE	699.01	54.24	46.80	13.00	776.26
ALCON LABS	NYSE	58.24	6.36	4.88	1.79	62.14
ALLD PRODS	NYSE	304.92	6.39	4.96	8.60	184.55
AM BAKERIES	NYSE	417.24	5.74	1.98	9.90	109.50
AM HOME PRD	NYSE	2258.64	250.69	238.18	46.39	1390.71
AM MEDICAL	NYSE	219.33	5.23	4.23	11.00	288.49
AM NAT GAS	NYSE	845.17	92.23	71.07	0.00	2340.52
AM SHIPBLD	NYSE	108.03	0.91	0.97	3.41	79.24
AM STERLIZR	NYSE	127.16	5.88	5.64	3.70	93.34
AMER CHAIN & CABLE CO.	NYSE	327.76	6.71	6.77	7.99	245.18
AMERON INC	NYSE	208.86	8.24	7.70	3.90	135.07
AMP INC	NYSE	409.55	27.77	25.10	12.85	414.98
AMSTAR CORP	NYSE	1687.00	39.04	32.82	7.02	441.46
ANGELICA CP	NYSE	103.93	5.52	5.51	4.60	65.85
APACHE CP	NYSE	201.56	6.95	7.03	3.77	192.41
APCO OIL CP*	NYSE	287.95	-2.08	-3.31	0.00	198.54
APPLD MAGNT	NYSE	62.34	0.90	0.36	2.75	43.14
ARA SERVICE	NYSE	1197.65	30.30	24.39	66.80	532.08
ARCTIC ENT	NYSE	79.62	-2.79	-2.72	1.30	47.35
ASA LTD	NYSE	18.24	15.78	0.00	0.00	180.16

AVIS INC	NYSE	392.84	10.61	9.89	10.00	440.44
BACHE GROUP	NYSE	210.01	9.42	8.35	6.00	770.74
BARD C R	NYSE	131.59	9.70	8.50	3.27	97.85
BATH INDUSTRIES, INC.	NYSE	382.77	0.53	-1.71	11.23	236.83
BAKER INDS	NYSE	190.34	43.36	18.83	0.00	238.26
BELCO PETE	NYSE	306.29	21.22	12.34	0.00	404.55
BELL-HOWELL	NYSE	398.66	12.61	11.14	12.66	432.34
BLISS & LGH	NYSE	130.35	9.52	8.30	2.81	119.93
BOISE CASCD	NYSE	1458.05	63.89	35.18	28.98	1569.52
BRAUN, C.F., & CO.	NYSE	163.25	5.69	4.64	5.10	149.98
BRIGGS-STRA	NYSE	316.29	18.27	17.05	6.38	153.18
BROOKLYN UN	NYSE	267.20	17.84	3.52	3.47	501.35
BROWNG-FER	NYSE	256.33	15.02	14.42	7.25	334.43
BRUNSWK CP	NYSE	817.97	18.13	14.80	24.70	651.22
BUDGET CAPITAL CORP.	NYSE	31.82	-0.92	1.53	0.22	381.74
BUDGET INDS*	NYSE	56.00	-1.15	-1.05	0.00	465.15
CALIF-PAC	NYSE	49.54	3.26	0.06	0.79	106.41
CANAL-RAND	NYSE	34.90	2.15	1.46	1.13	93.34
CARO FRGHT	NYSE	101.00	-1.33	-1.61	3.62	58.39
CARRIER CP	NYSE	929.86	13.47	9.30	23.21	763.47
CECO CORP	NYSE	258.36	8.80	8.55	6.74	149.68
CEN TEL&UTL	NYSE	370.06	43.92	39.77	10.55	1147.75
CENTEX CORP	NYSE	280.31	5.46	3.90	3.70	376.78
CENTL & SW	NYSE	740.15	95.73	74.32	0.00	1982.29
CENTL IL LT	NYSE	178.17	18.03	13.31	1.59	681.41
CENTL IL PS	NYSE	240.56	27.81	17.12	0.00	752.68
CHAMPN INTL	NYSE	2399.26	61.02	23.57	47.70	1972.24

CLIENTS OF ARTHUR ANDERSEN & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
CHRIS-CRAFT*	NYSE	61.15	-3.10	-3.05	1.93	131.58
CINN G & E	NYSE	479.87	49.74	13.06	0.00	1304.55
CMI INVESTMENT CORP.	NYSE	25.76	0.06	-6.44	0.34	142.89
CMNWLTH ED	NYSE	1722.33	206.91	151.54	0.00	5688.14
COLGATE-PAL	NYSE	2860.49	118.96	104.98	42.00	1443.63
COLLINS FD	NYSE	110.75	0.17	0.16	3.90	46.26
COLMBIA GAS	NYSE	1443.14	111.46	90.93	0.00	3202.66
COLT INDS	NYSE	1022.76	52.13	36.23	21.80	866.27
COLUMBUS&SO	NYSE	259.08	42.42	10.99	2.79	950.81
COMBSTN ENG	NYSE	1711.15	44.59	38.85	0.00	1054.48
COMPGRAPHIC	NYSE	74.40	5.84	2.89	2.00	50.54
CONS FOODS	NYSE	2443.03	50.61	50.79	78.00	1036.81
CONS FRGHT	NYSE	631.23	18.09	15.50	16.05	338.66
CONSUMR PWR	NYSE	1341.10	100.73	54.42	0.00	3361.13
CONT TEL CP	NYSE	508.87	54.34	29.43	0.00	2009.29
COOK UNITED	NYSE	400.38	1.52	1.49	7.00	188.63
CORDURA CP	NYSE	70.79	-0.67	-0.46	0.00	63.20
COUSINS MTG	NYSE	23.43	-60.74	0.00	0.00	315.50
CROCKER NAT	NYSE	798.14	39.88	18.87	10.86	0449.10
CULLIGAN	NYSE	77.81	3.42	3.21	1.97	65.15
CUMMINS ENG	NYSE	761.50	8.04	11.65	17.97	624.00
CUNGHAM DRG	NYSE	129.53	0.79	0.44	3.25	41.23

CUTLER-HAMR	NYSE	400.93	15.34	17.37	13.90	267.96
DAYTON P&L	NYSE	357.57	41.17	15.13	3.12	895.98
DELTA AIRL	NYSE	1377.03	49.22	25.39	27.80	1353.71
DICK (AB)	NYSE	280.75	5.32	5.71	7.11	162.93
DISSTON, INC.	NYSE	55.15	2.89	2.06	1.75	37.80
DONNELLY RR	NYSE	501.56	35.32	32.90	11.70	410.90
DORSEY CORP	NYSE	158.13	2.23	1.41	5.10	102.09
DRESSR INDS	NYSE	2011.60	123.90	100.10	51.00	1424.40
DYMO INDS	NYSE	171.19	3.31	6.00	5.90	113.29
EASTN GS&FL	NYSE	591.83	57.96	32.84	10.70	674.96
EG&G INC	NYSE	176.06	6.88	6.26	0.00	84.60
ELCTRN ASSC	NYSE	33.57	1.00	0.80	0.99	28.06
ELIXIR INDS	NYSE	86.54	1.73	1.77	1.90	57.43
ENGELHARD	NYSE	5672.52	114.72	61.31	0.00	1325.06
ENTEX INC	NYSE	190.88	12.46	8.93	2.36	204.93
ESTERLIN CP	NYSE	124.75	2.95	3.21	3.24	79.97
FED SIGNAL	NYSE	68.70	2.74	2.61	1.85	51.06
FEDERAL CO	NYSE	476.69	8.47	7.64	7.50	124.23
FLA PWR CP	NYSE	504.50	67.04	34.24	3.37	1524.60
FLEETWD ENT	NYSE	300.51	5.08	4.39	6.00	106.61
FLEXI-VAN	NYSE	90.20	3.91	1.49	0.00	249.82
FLORIDA GAS CO.	NYSE	135.49	17.62	16.39	1.21	448.20
FOOTE CONE	NYSE	57.79	3.62	4.66	2.13	53.44
FST CHICAGO	NYSE	1447.01	105.52	44.16	7.86	9012.00
FST INTL BN	NYSE	435.06	51.71	10.89	3.81	6356.37
FT HOWARD	NYSE	203.70	36.81	38.26	2.71	188.04
GARDNER-DEN	NYSE	423.14	32.54	28.80	11.05	371.48

CLIENTS OF ARTHUR ANDERSEN & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
GEN DYNAMCS	NYSE	2160.04	81.09	47.71	63.80	1338.08
GEN PORTLND	NYSE	156.87	0.47	-1.30	0.00	206.36
GEN TEL &EL	NYSE	5948.39	388.16	390.09	187.00	2713.70
GEORGIA-PAC	NYSE	2358.61	148.02	83.50	33.50	2403.87
GETTY OIL	NYSE	2983.58	256.69	451.23	11.69	3239.86
GROLIER INC*	NYSE	248.69	-13.78	-13.63	0.00	309.70
GRT NO-NEK	NYSE	647.12	42.47	31.40	12.00	697.47
GULF RESRCS	NYSE	296.44	28.66	15.38	4.29	277.33
HALLIBURTON	NYSE	4209.60	222.51	181.32	85.25	2092.07
HARCRT BRAC	NYSE	241.35	14.89	15.62	0.00	164.94
HAZELTINE	NYSE	83.84	1.21	0.51	0.00	55.68
HEILEMN BRW	NYSE	171.17	5.71	6.22	0.00	86.56
HELLER INTL	NYSE	363.20	27.29	22.77	0.00	3102.92
HELMRH &PYN	NYSE	63.49	13.42	7.09	1.33	135.88
HERSHY FOOD	NYSE	556.33	39.29	41.68	7.15	298.39
HOFFMN ELEC	NYSE	49.97	0.72	0.64	1.72	35.71
HOLIDAY INN	NYSE	912.20	41.45	26.66	0.00	929.69
HUBBARD RLT	NYSE	8.72	-0.35	0.00	0.00	90.66
HUTTON E F	NYSE	246.74	20.14	23.71	0.00	622.51
IA-ILL G&E	NYSE	188.51	18.02	15.71	1.37	459.93
ILL TOOL WK	NYSE	199.42	14.99	13.90	6.20	176.62
INDIANA GAS	NYSE	107.54	5.50	5.16	1.13	189.72

INEXCO OIL	NYSE	47.08	4.87	1.19	0.26	134.40
INSTITUTNL	NYSE	18.60	-6.99	0.00	0.00	185.79
INTL PAPER	NYSE	3080.80	218.00	153.30	50.84	3341.00
INTL TEL&TL	NYSE	1367.50	398.17	333.24	376.00	0407.90
IOWA ELEC	NYSE	159.37	10.47	8.90	0.00	452.03
IOWA P&L	NYSE	162.67	17.33	12.31	1.42	392.92
IOWA PS CO	NYSE	123.96	15.06	13.28	1.51	395.59
ITE IMPERL	NYSE	503.66	17.42	13.17	14.00	384.28
ITEK CORP	NYSE	199.52	0.04	0.02	5.85	132.53
ITT CONS SERV CORP.	NYSE	65.98	7.50	0.03	6.50	169.76
JAMES FRED	NYSE	63.23	6.15	6.00	2.00	113.44
KAN CTY P&L	NYSE	210.32	26.60	15.70	2.48	736.53
KAN-NEBR GS	NYSE	142.02	11.58	9.47	1.72	262.47
KANSAS P&L	NYSE	175.98	16.96	11.69	1.64	413.74
KEENE CORP	NYSE	139.11	4.15	3.47	2.58	124.09
KENNAMETAL	NYSE	143.03	16.82	14.43	3.96	121.99
KERR-MCGEE	NYSE	1798.58	131.08	91.80	10.31	1387.88
KIDDE WALTER	NYSE	1155.88	43.18	38.22	35.00	854.89
KIRSCH CO	NYSE	95.58	1.75	1.22	3.01	72.58
KOEHRING CO	NYSE	354.75	6.45	1.09	6.90	280.45
KRAFTCO CP	NYSE	4857.37	139.55	128.68	0.00	1671.17
KY UTIL CO	NYSE	221.09	24.26	19.47	1.63	613.56
L F E CORP	NYSE	69.50	1.28	1.80	2.14	48.07
LA PACIFIC	NYSE	386.70	16.71	4.17	0.00	549.69
LEVI STRAUS	NYSE	1015.21	64.74	71.94	30.00	496.28
LOUSVLE G&E	NYSE	198.84	24.62	20.95	0.00	594.59
LUKENS STL	NYSE	278.60	10.88	10.20	4.81	163.16

CLIENTS OF ARTHUR ANDERSEN & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
M-G-M INC	NYSE	254.99	31.86	19.23	6.60	312.50
MACKE CO	NYSE	177.00	-1.57	1.40	8.70	81.59
MARCOR	NYSE	4667.48	120.38	105.66	120.90	3169.02
MAREMONT CP	NYSE	292.44	8.90	6.29	7.73	192.08
MARLEY CO	NYSE	171.89	6.89	6.18	3.93	124.70
MARQUETTE	NYSE	111.72	4.65	-1.44	1.76	155.43
MARRIOTT CP	NYSE	732.40	21.82	16.59	46.20	737.14
MARSH&MCLEN	NYSE	244.47	34.57	36.84	7.24	178.66
MARSHAL FLD	NYSE	547.60	20.31	19.01	19.63	333.79
MASONITE CP	NYSE	288.08	1.88	1.25	7.52	296.93
MAY DEPT	NYSE	1696.68	46.78	46.91	55.00	1205.62
MCGRAW EDSN	NYSE	909.60	17.14	12.89	26.00	633.01
MEI CORP	NYSE	86.01	4.07	4.69	0.00	57.91
MERC STORES	NYSE	563.86	21.03	19.20	16.50	273.87
MERCK & CO	NYSE	1489.66	228.78	147.70	26.80	1573.69
MESA PETE	NYSE	51.13	24.87	0.00	0.29	405.05
MICH GAS UT	NYSE	49.36	2.79	2.25	0.35	79.86
MIRRO ALUM	NYSE	100.28	3.37	3.32	3.24	70.69
MO PUB SERV	NYSE	71.79	7.25	6.16	0.00	238.58
MOHAWK DATA	NYSE	170.11	-21.01	4.28	4.20	211.71
MOORE MCCOR	NYSE	275.05	30.65	13.13	2.60	442.09
NATL MED CAR	NYSE	77.88	5.62	6.09	3.00	80.35

NATL SERV	NYSE	448.30	17.63	16.30	17.60	229.07
NATL TEA CO	NYSE	1403.81	-2.64	-0.25	21.00	242.31
NATOMAS CO	NYSE	189.68	36.45	50.79	0.00	504.58
NEV PWR CO	NYSE	91.40	12.23	-2.94	0.70	381.39
NEW ENG G&E	NYSE	238.33	13.39	5.39	0.00	493.63
NEWMONT MNG	NYSE	516.52	52.89	22.20	0.00	1129.55
NOR IL GAS	NYSE	716.38	48.58	43.92	2.84	1096.03
NOR IND P S	NYSE	536.75	53.66	31.90	0.00	1469.73
NOR NAT GAS	NYSE	1163.20	131.14	116.03	0.00	1904.99
NORWESTN STL	NYSE	304.26	26.83	20.37	4.15	238.20
NORWST ENERG	NYSE	482.58	22.50	15.29	1.19	488.54
NORWST INDS	NYSE	1187.50	101.13	76.33	30.00	1184.14
OAK INDS	NYSE	113.01	1.02	0.06	7.37	91.52
OCCID PET	NYSE	5345.94	174.61	441.37	32.94	3503.37
OHIO EDISON	NYSE	593.32	86.46	70.14	0.00	2048.14
OKLA G&E	NYSE	274.42	39.41	21.80	3.12	938.46
OUTBRD MARN	NYSE	498.39	23.23	16.41	13.85	395.44
OWENS-CORNG	NYSE	884.94	41.80	35.10	16.60	743.57
PARSONS INC	NYSE	109.91	4.74	4.14	2.12	113.77
PARK E H N	NYSE	131.17	10.05	10.51	4.13	95.46
PASCO INC	NYSE	259.15	11.56	9.90	0.00	219.26
PENNWALT CO	NYSE	713.74	31.63	24.15	14.30	540.94
PENNZOIL CO	NYSE	1078.31	106.82	55.10	9.43	2026.60
PEOPLES ENRG	NYSE	247.99	-0.15	-0.85	0.00	78.54
PEOPLES GAS	NYSE	934.59	103.84	87.89	6.51	2198.80
PORTLND GEN	NYSE	179.94	46.00	1.42	2.12	1046.40
PS CO IND	NYSE	305.90	54.50	38.16	3.50	1233.67

CLIENTS OF ARTHUR ANDERSEN & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
QUAKER OATS	NYSE	1389.01	31.04	36.26	25.10	765.06
REECE CORP	NYSE	34.26	3.09	2.64	1.17	51.72
RELIABL STR	NYSE	70.82	1.54	1.49	2.00	59.82
REP CORP	NYSE	247.21	6.43	7.81	6.00	117.48
RETAIL CREDIT CO	NYSE	230.94	8.54	8.48	12.76	76.53
REXNORD INC	NYSE	553.85	25.05	23.35	13.30	349.91
RICHRDSN CO	NYSE	122.06	1.28	0.36	2.40	69.61
RIEGEL TXTL	NYSE	236.63	8.18	7.13	8.50	147.84
SARG-WELCH	NYSE	59.73	3.50	3.55	1.50	45.37
SCHLITZ JOS	NYSE	922.99	30.90	30.02	0.00	670.23
SCOTT FRSMN	NYSE	140.45	9.62	9.40	2.65	132.51
SCOTTYS INC	NYSE	77.51	1.83	1.54	1.36	46.44
SEALED PWR	NYSE	141.89	6.95	7.44	4.21	116.32
SEARLE G D	NYSE	711.80	80.54	12.76	19.40	897.81
SIGNODE CP	NYSE	357.56	17.10	16.37	5.77	272.21
SKELLY OIL	NYSE	1043.05	89.55	81.16	4.54	1012.63
SMITH INTL	NYSE	292.68	34.40	27.06	5.80	261.76
SO IND GAS	NYSE	82.75	10.54	9.77	0.69	214.15
SOUTHN CO	NYSE	1998.91	278.77	187.64	0.00	7237.00
ST JOS L&P	NYSE	31.88	2.41	1.85	0.46	82.31
STANRAY CP	NYSE	75.75	3.18	3.19	1.32	45.55
STD BRANDS	NYSE	1944.98	66.90	54.23	20.60	947.26

STEWART WRN	NYSE	241.18	13.13	12.49	8.50	171.54
STORAGE TEC	NYSE	98.80	5.71	4.46	2.16	125.99
STUDE-WORTH	NYSE	1067.16	26.26	27.26	22.90	883.64
SUAVE SHOE	NYSE	65.06	1.42	1.32	1.63	33.77
SUN CHEM	NYSE	281.33	2.46	1.02	4.60	213.24
SUPERIOR OIL	NYSE	382.15	51.93	54.80	3.34	986.78
TAPPAN CO	NYSE	214.69	-2.72	-3.25	4.70	124.59
TELEDYNE	NYSE	1714.97	101.71	85.30	45.40	1141.88
TENNECO INC	NYSE	5630.33	342.94	256.15	78.38	6584.20
TEXACO INC	NYSE	4507.50	830.58	982.05	75.24	7262.40
THRIFTY DRG	NYSE	546.72	5.68	5.02	12.00	181.20
TIGER INTL	NYSE	321.91	15.02	8.37	4.72	1112.57
TOLEDO EDSN	NYSE	191.56	35.38	7.53	0.00	759.04
TRANS UNION	NYSE	578.83	16.85	20.03	10.70	1396.18
TRANSCO COS	NYSE	520.28	23.29	15.20	0.00	1531.98
TRIANGL-PAC	NYSE	166.47	1.87	1.20	2.77	93.54
TX GAS TRAN	NYSE	708.72	43.38	34.91	7.80	874.07
U S GYPSUM	NYSE	820.43	30.46	17.56	18.70	760.59
U S HOME CP	NYSE	308.25	-2.98	-1.61	2.00	370.88
U S SHOE CP	NYSE	473.42	13.41	11.98	16.00	245.77
U-L INC	NYSE	2409.87	-5.31	0.12	61.65	2685.75
UARCO INC	NYSE	179.64	9.01	8.59	4.25	86.59
UNARCO INDS	NYSE	175.93	10.54	10.55	2.50	94.89
UNION COMM	NYSE	114.30	-5.13	-1.58	1.25	1519.96
UNIV OIL PRDS CO	NYSE	615.05	-31.36	5.63	11.04	440.93
UNIVAR CORP	NYSE	522.05	15.54	14.28	3.59	153.50
UTAH INTL	NYSE	686.26	135.39	107.38	5.15	1045.64

CLIENTS OF ARTHUR ANDERSEN & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
UTD GAS	NYSE	884.23	36.51	28.33	2.06	652.67
VENDO CO	NYSE	69.16	-2.68	-1.36	0.00	62.77
VSI CORP	NYSE	150.40	6.44	6.58	2.94	95.61
WALGREEN CO	NYSE	1079.14	9.85	5.06	29.00	292.50
WALLACE BUS	NYSE	65.58	4.13	4.30	1.27	39.46
WALLACE-MUR	NYSE	283.56	12.89	12.50	7.90	209.37
WARNER CO	NYSE	59.83	3.02	1.43	0.00	66.39
WASH GAS LT	NYSE	225.09	8.75	2.20	2.91	434.85
WASTE MGMT	NYSE	158.48	9.26	7.89	4.00	207.53
WELLS F MTG	NYSE	21.72	-3.88	0.00	0.00	212.43
WEYENBERG	NYSE	70.36	2.26	2.34	0.00	35.81
WEYERHAEUSR	NYSE	2421.27	191.89	113.40	46.60	3245.28
WHEELABRATR	NYSE	332.18	14.56	10.19	0.00	242.14
WILSHIRE TX	NYSE	26.93	5.26	1.07	0.00	53.37
WISC P.S.	NYSE	219.95	23.45	22.74	1.82	502.72
WISCONSIN GAS CO.	NYSE	157.64	9.82	5.23	1.53	244.77
XTRA INC	NYSE	78.11	1.23	0.95	0.64	194.79
ZAPATA CORP	NYSE	350.78	30.29	7.21	6.50	797.60
ZNTH RADIO	NYSE	900.51	25.96	19.20	22.93	491.58
A&E PLASTIK	AMSE	51.19	2.28	1.94	1.05	23.91
AAR CORP	AMSE	54.63	1.87	1.29	0.65	43.35
ACME PRECSN	AMSE	11.37	0.27	0.23	0.33	5.43

AEGIS CORP	AMSE	61.49	1.86	1.59	0.00	32.59
AERO-FLOW	AMSE	53.08	1.59	1.67	0.58	23.04
AFFIL PUBLN	AMSE	108.30	4.64	4.90	2.15	51.77
AM GARDN PR	AMSE	33.71	0.90	0.74	0.87	26.59
AM SCIENCE	AMSE	20.46	1.08	1.15	0.50	11.29
AM TRAINING	AMSE	5.58	-1.02	-0.51	0.16	3.75
ARMIN CORP	AMSE	46.54	5.11	4.89	0.48	32.27
ATALANTA CP	AMSE	107.15	1.26	0.91	0.00	32.63
AUSTRAL OIL	AMSE	18.95	4.15	3.65	0.11	67.08
BANNER INDS	AMSE	93.55	3.47	2.70	2.50	56.67
BARNES ENG	AMSE	11.52	-0.38	-0.08	0.36	6.79
BUILDEX INC	AMSE	55.52	1.36	1.27	1.50	43.04
BURNS INTL	AMSE	168.38	3.27	3.09	42.00	60.92
C & K PETRO	AMSE	13.32	3.58	1.66	0.00	40.87
CANCO INC	AMSE	34.21	1.36	0.70	1.22	32.42
CAROLINA PIPELINE CO.	AMSE	36.38	3.13	3.14	0.12	37.50
CASTLE A M	AMSE	241.09	4.96	4.68	1.30	81.12
CAVITRON CP	AMSE	21.35	1.26	1.37	0.49	10.72
CDN OCCID	AMSE	51.66	12.06	7.66	0.47	151.15
CETEC CORP	AMSE	35.14	0.35	0.21	0.79	18.38
COLU NATL	AMSE	105.80	2.77	2.49	5.40	51.74
COMCDR BUS	AMSE	55.88	-4.37	-0.28	0.72	25.82
CONNOLCER CORP, THE	AMSE	15.26	-2.01	0.00	0.41	8.05
CONCHEMCO	AMSE	85.04	0.28	0.13	1.80	34.80
CORE LABS	AMSE	28.02	1.56	1.24	1.00	21.77
CRAMER ELEC	AMSE	122.04	0.12	0.12	1.06	63.40
DAMSON OIL	AMSE	9.24	0.61	0.00	0.10	25.64

CLIENTS OF ARTHUR ANDERSEN & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
DEPOSITORS CORP.	AMSE	28.76	2.82	-0.88	0.83	327.96
DEROSE INDS	AMSE	14.53	-1.50	0.00	0.43	5.33
DYNALECTRON	AMSE	176.46	3.17	3.79	0.00	71.11
ECODYNE CP	AMSE	170.31	4.28	3.88	3.11	95.73
ELCOR CHEM	AMSE	63.70	2.40	2.19	0.84	26.94
ELCTRN ASIS	AMSE	38.63	0.42	0.33	0.80	27.40
ESSEX CHEM	AMSE	49.09	2.49	1.86	0.00	30.15
EUTHENICS SYSTEM CORP.	AMSE	34.16	0.96	0.99	1.52	18.22
FABRI-CENTR	AMSE	58.18	2.43	2.09	2.50	28.94
FALCN SEABD	AMSE	66.98	12.64	5.41	0.48	54.66
FELMONT OIL	AMSE	17.87	1.03	0.26	0.12	51.80
FILMWAY INC	AMSE	70.79	1.48	1.52	0.00	35.01
FINL GEN BK	AMSE	136.37	7.59	-0.70	0.00	1830.44
FOOTE MINRL	AMSE	103.95	9.76	7.07	1.36	126.82
FRANTZ MFG	AMSE	37.18	1.97	2.07	0.51	18.98
FRIGITEMP	AMSE	69.02	3.35	3.57	2.40	53.34
FST HARTFRD	AMSE	68.11	-3.71	0.19	2.20	38.92
GABRIEL IND	AMSE	34.75	1.56	1.46	0.90	27.79
GEN RECREAT	AMSE	43.50	-2.09	-1.91	0.00	32.77
GEN RESRCH	AMSE	43.65	0.34	0.57	1.21	24.00
GEON INDUSTRIES, INC.	AMSE	51.89	-0.84	-0.72	0.81	40.01
GLADDING CP	AMSE	64.05	-3.36	-0.61	2.10	57.14

GLASROCK PD*	AMSE	12.81	0.27	0.27	0.46	13.18
GLOBE INDS	AMSE	44.47	4.42	4.38	0.00	18.82
GLOUCESTER	AMSE	30.98	1.99	2.28	0.60	25.78
GOLD W MCBL	AMSE	36.32	-0.23	-0.22	0.66	9.63
GOLDBLAT BR	AMSE	264.43	0.24	-0.22	10.00	137.21
GRT BASINS	AMSE	10.43	-0.61	0.50	0.08	29.41
GTI CORP	AMSE	11.89	-2.69	-0.33	0.52	9.61
GUILFD MILL	AMSE	100.74	0.28	-0.38	1.28	47.59
GULF REPUB FIN CORP.	AMSE	22.40	1.87	0.63	0.19	269.78
HARVEY'S STORES	AMSE	0.00	0.00	0.00	0.00	0.00
HI-SHEAR CORP.	AMSE	26.98	1.42	1.06	0.89	20.57
INCOTERM CP	AMSE	21.40	0.15	0.20	0.61	16.45
INLAND CREDIT CORP.	AMSE	3.19	0.36	0.31	0.01	22.29
INST SYSTEM	AMSE	209.08	0.44	0.43	5.00	176.42
INTERMEDCO	AMSE	49.63	1.26	1.22	0.53	20.51
INTERPHOTO	AMSE	42.82	-4.75	0.00	0.31	21.09
INTERPOOL	AMSE	26.24	3.93	0.81	0.00	102.30
INTL ALUM	AMSE	38.56	2.52	2.44	1.00	26.92
INTL GEN	AMSE	72.46	5.36	4.52	1.95	68.70
ITI CORP.	AMSE	0.14	-0.94	0.00	0.02	2.23
JACOBS ENGR	AMSE	142.15	3.04	2.64	1.53	41.64
K-TEL INTL	AMSE	87.83	3.22	2.97	0.44	37.01
KEYSTN INDS	AMSE	32.17	1.52	1.48	0.61	18.52
KING RADIO	AMSE	46.73	1.22	1.09	0.00	28.40
KIRBY INDS	AMSE	84.93	6.94	4.88	1.50	107.44
KLEINERTS	AMSE	66.70	-1.47	0.16	3.51	51.18
KLIKLOK CORP.	AMSE	18.35	2.72	2.56	0.45	21.74

CLIENTS OF ARTHUR ANDERSEN & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
LCA CORP.	AMSE	284.64	9.00	9.60	6.50	215.76
LA. GEN. SERVICES, INC.	AMSE	30.47	1.17	0.91	0.44	64.05
MARK CONTRL	AMSE	71.45	6.01	5.55	1.58	40.82
MARSHAL INC	AMSE	43.12	1.29	1.17	0.37	14.41
MEDALST IND	AMSE	84.48	1.72	1.44	0.00	55.79
MICH GEN CP	AMSE	152.20	3.32	3.20	0.00	99.38
MITCHEL ENG	AMSE	99.39	12.31	2.70	1.59	347.53
MCC MAID FD	AMSE	31.98	-0.09	-0.13	0.37	14.53
MULTI AMP	AMSE	6.66	0.21	0.02	0.18	6.89
NELSON L B	AMSE	44.01	-2.66	0.00	0.00	76.99
NO AM ROYAL	AMSE	58.13	2.80	0.78	1.25	50.27
NOEL INDS	AMSE	18.86	0.47	0.41	1.27	11.66
NORTEK INC	AMSE	48.60	1.67	0.68	1.82	67.28
OAKWD HOMES	AMSE	20.66	0.74	0.71	0.40	16.75
ORMAND INDS	AMSE	18.39	0.13	0.19	0.38	17.75
OUTDOOR SPT	AMSE	42.16	1.45	1.38	0.00	30.60
PAC HOLDNG	AMSE	39.10	1.90	1.92	0.00	33.96
PARKWAY DSTRB INC	AMSE	59.14	1.83	2.09	0.80	18.84
PAXALL INC	AMSE	52.98	2.12	2.56	0.00	30.30
PERINI CORP	AMSE	211.09	5.76	6.03	4.00	130.30
PERTEC CORP	AMSE	48.02	2.78	2.80	0.92	27.05
PETRO-LEWIS	AMSE	13.68	0.36	0.93	0.29	45.68
PIONEER SYS	AMSE	46.20	-1.68	1.00	1.70	33.38

PIONEER TEX	AMSE	49.47	3.75	3.23	0.71	41.79
PLANT INDS	AMSE	60.77	3.15	3.19	1.35	48.42
POLYCHRM CP	AMSE	58.46	3.17	2.42	1.30	47.63
PRUD BLDG	AMSE	101.73	2.10	2.52	0.00	32.99
RICHTN INTL	AMSE	75.62	1.42	2.01	2.20	44.29
RILEY CO	AMSE	188.37	2.78	3.27	3.60	108.15
ROCOR INTL	AMSE	115.53	1.98	1.85	0.00	56.33
RSC INDS	AMSE	13.94	1.03	1.06	0.42	10.10
RYERSN &HAY	AMSE	15.21	0.04	0.05	0.24	25.67
SALEM CO	AMSE	111.12	3.10	3.40	0.85	43.43
SCIEN-ATLA	AMSE	35.73	1.25	1.15	1.18	21.82
SCRIVNR INC	AMSE	339.45	3.35	2.63	3.30	57.78
SEMTECH	AMSE	10.77	0.88	0.92	0.00	8.93
SERVO CP-AM	AMSE	9.72	0.36	0.28	0.25	7.11
SHAW INDS	AMSE	86.83	3.47	2.90	1.60	57.85
SHENAND OIL	AMSE	22.20	6.46	0.00	0.18	74.42
SHERWD MED	AMSE	152.11	5.64	5.90	4.98	128.11
SIFCO INDS	AMSE	33.32	2.05	1.65	0.74	25.19
SOUTH CALIF EDISON CO.	AMSE	1483.43	218.30	135.14	13.47	4403.94
SPEED-O-PRT	AMSE	7.60	0.19	0.17	0.00	6.20
SPLENTEX*	AMSE	15.95	0.87	-0.30	1.02	10.53
STATE S.& L.ASSN.	AMSE	26.00	2.15	1.27	0.19	337.90
STD METALS	AMSE	7.46	1.27	0.34	0.00	10.99
STD PRDS CO	AMSE	109.58	2.77	2.97	3.45	52.65
STD-PACIFIC	AMSE	44.62	1.78	1.86	0.24	60.47
STEPAN CHEM	AMSE	89.09	4.01	3.37	0.00	61.34
STERLNG ELE*	AMSE	62.00	1.23	1.34	1.02	22.76

CLIENTS OF COOPERS AND LYBRAND

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
ALBANY INTL	NYSE	195.77	5.55	4.40	6.13	209.12
ALLC MAIN	NYSE	98.63	5.07	5.42	18.60	52.11
ALLEN GROUP	NYSE	227.13	3.82	2.54	5.33	134.03
ALUM CO-AM	NYSE	2305.90	64.80	-6.00	44.10	3419.90
AM BRANDS	NYSE	2569.70	140.03	162.49	0.00	2409.39
AM CAN CO	NYSE	2870.15	77.30	63.25	50.10	1855.28
AM TEL &TEL	NYSE	8957.21	3147.72	2390.24	0.00	0156.18
AMAL SUGAR	NYSE	174.05	23.39	22.59	3.30	119.72
AMAX INC	NYSE	962.09	134.37	25.23	13.34	2480.12
ARMADA CORP	NYSE	41.49	0.59	1.14	0.59	36.61
ASARCO INC	NYSE	1004.64	25.44	-10.07	13.50	1501.63
ATLANTC RIC	NYSE	7307.85	350.39	545.96	28.10	7364.78
ATLAS CORP	NYSE	51.78	1.69	1.72	1.56	52.85
BALT G & E	NYSE	680.04	93.36	18.16	7.82	2187.14
BOSTON EDSN	NYSE	501.74	33.75	26.15	3.97	1310.31
BROWN &SHRP	NYSE	86.87	-0.39	-1.59	3.25	83.65
CABOT CP	NYSE	410.10	14.10	10.77	5.56	477.31
CALLAHN MIN	NYSE	21.21	2.81	1.35	0.00	28.80
CARPNTR TCH	NYSE	296.42	21.87	21.24	4.51	193.65
CBS INC	NYSE	1938.87	122.90	126.54	30.00	1193.11
CCI CORP*	NYSE	111.96	-0.60	0.65	2.41	80.26
CENTL LA EL	NYSE	163.16	22.21	14.85	0.00	411.97

CHESAPK CP	NYSE	130.96	10.18	8.60	2.03	130.44
CINN BELL	NYSE	174.75	22.69	16.48	5.19	440.00
CON AGRA*	NYSE	573.54	4.07	0.53	4.20	126.31
CONT COPPER	NYSE	139.80	5.44	5.44	2.10	104.61
COPPER RNGE	NYSE	102.20	-13.69	-7.70	3.55	162.85
CROUSE-HIND	NYSE	208.61	12.82	10.84	0.00	120.52
CROWN ZELRB	NYSE	1767.22	74.45	51.26	30.85	1523.08
CURTISS-WRT	NYSE	273.27	10.35	9.35	6.57	306.84
CYPRUS MINE	NYSE	365.25	29.78	12.43	0.00	600.22
DAMON CORP	NYSE	136.64	1.85	1.61	4.50	106.52
DELMRVA P&L	NYSE	278.55	32.79	1.99	2.36	934.72
DEXTER CORP	NYSE	145.17	6.76	7.25	0.00	107.89
DICTAPHONE	NYSE	100.98	2.72	2.67	0.00	65.85
DIGITAL EQ	NYSE	533.77	46.00	27.60	19.00	565.07
DIVERFD INC	NYSE	161.18	-3.54	-0.22	2.75	97.81
DUN & BRAD	NYSE	552.07	41.85	42.30	0.00	380.41
DUPLAN CORP	NYSE	115.97	-13.71	0.22	3.90	101.13
EMERY INDS	NYSE	181.12	10.67	9.65	1.75	143.14
ETHYL CORP	NYSE	1029.22	61.00	51.41	17.00	875.81
FIRESTN TIR	NYSE	3724.15	134.30	94.70	111.00	3180.80
FLINTKOTE	NYSE	435.25	12.44	3.16	8.05	439.77
FORD MOTOR	NYSE	4009.10	227.50	151.90	416.12	4020.20
FREEPORT ML	NYSE	291.78	34.52	8.50	3.50	429.86
FST NAT BCS	NYSE	726.92	42.47	19.79	9.10	8614.10
GARFINCKEL	NYSE	230.54	7.86	6.11	14.40	142.31
GEN GROWTH	NYSE	29.56	5.73	0.00	0.00	224.22
GEN PUB UTL	NYSE	942.00	133.23	59.84	10.33	3631.98

CLIENTS OF COOPERS AND LYBRAND--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
GEN REFRACT	NYSE	320.10	9.77	7.33	9.86	231.60
GENSTAR LTD	NYSE	720.10	47.16	37.40	10.13	704.61
GLOBAL MAR	NYSE	89.14	5.50	4.62	1.80	140.82
GUARDN INDS	NYSE	106.68	7.05	5.17	2.37	103.61
GULF STATE	NYSE	365.26	51.43	29.10	0.00	1432.01
HAMMOND CP	NYSE	126.55	-3.83	-3.92	3.75	93.75
HARSCO CORP	NYSE	521.56	35.65	33.82	13.40	357.77
HECLA MIN	NYSE	29.28	5.95	3.43	2.51	137.12
HELENE CURT	NYSE	87.11	1.90	1.84	1.50	32.69
HERCULES	NYSE	1413.11	32.46	8.19	23.48	1316.25
HIGH VOLTGE	NYSE	33.89	0.87	0.72	0.00	37.11
HMW INDS	NYSE	57.54	2.31	2.35	1.50	33.24
HORIZON CP	NYSE	45.59	0.38	0.25	1.12	179.12
HUMANA INC	NYSE	195.41	6.83	3.84	13.80	310.91
INTL RECTFR	NYSE	68.02	0.91	1.24	2.90	51.12
INTRST UTD	NYSE	262.65	3.06	2.65	12.50	85.99
JOHNS-MANVL	NYSE	1107.01	38.41	31.33	24.00	1077.38
JOHNSN-JHNS	NYSE	2224.68	183.82	126.33	53.80	1551.50
KENNECOTT	NYSE	768.55	21.74	-39.90	17.10	2223.70
KEYSTN CONS	NYSE	337.62	11.37	8.26	6.65	240.28
KROGER CO	NYSE	5339.22	34.44	24.79	56.97	1084.74
LANE BRYANT	NYSE	332.91	8.85	8.80	8.00	130.96

LEEDS NORTH	NYSE	138.22	3.00	2.50	5.17	124.72
LEHIGH VALY	NYSE	109.91	1.22	0.70	2.58	58.50
LCA STAR IN	NYSE	611.46	19.31	7.55	12.88	548.79
LORAL CORP	NYSE	54.82	2.81	2.39	1.70	31.31
LYNCH COMM	NYSE	20.61	1.09	1.00	0.81	16.65
MACANDREWS	NYSE	101.14	2.54	1.43	1.48	55.54
MANHATN IND	NYSE	223.84	-7.90	-5.00	7.27	119.74
MARYLND CUP	NYSE	264.82	10.47	9.17	7.80	204.03
MASCO CORP	NYSE	310.86	33.67	29.14	0.00	292.80
MASSMUTL MG	NYSE	19.91	5.46	0.00	0.00	219.72
MID CONT TL	NYSE	120.74	15.82	7.77	3.28	488.94
MILTON BRAD	NYSE	174.01	9.06	8.66	4.15	152.76
MINN MIN&MF*	NYSE	3127.34	261.62	195.00	78.43	3016.76
MONARCH MCH	NYSE	61.05	2.86	2.49	2.04	57.81
MORRISN-KNU	NYSE	997.82	10.72	9.50	26.10	335.91
MTN STS TEL	NYSE	1358.26	164.84	125.58	38.96	3726.10
MURPHY G C	NYSE	553.69	9.75	8.57	21.00	231.56
N L INDS	NYSE	1597.47	77.92	47.81	25.80	1033.48
N Y ST E&G	NYSE	340.78	43.68	4.48	4.15	1127.61
NABISCO INC	NYSE	1970.83	59.04	75.72	47.00	1014.39
NATL PRESTO	NYSE	110.02	9.43	8.98	1.90	93.91
NEW ENG EL	NYSE	586.20	49.94	27.25	6.50	1562.58
NEW ENG T&T	NYSE	1460.57	123.18	94.41	42.38	3835.05
NEW ENG MU LI INS. CO.[1]	NYSE	778.13	13.22	0.00	5.50	4260.94
OAKITE PRDS	NYSE	44.24	2.74	3.20	0.86	23.56
ORANGE-CO	NYSE	64.53	3.38	2.74	1.84	72.18
PAC TEL&TEL	NYSE	3289.77	310.95	256.47	94.72	8249.98

CLIENTS OF COOPERS AND LYBRAND--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
PAC TIN CON	NYSE	15.22	2.32	1.34	0.72	17.66
PAN AM WRLD	NYSE	1527.96	-81.77	-51.28	31.91	1637.26
PARKER-HANN	NYSE	411.15	19.34	20.18	11.09	268.81
PHILA ELEC	NYSE	1134.81	143.93	74.99	9.92	3961.46
PHILIP MOR	NYSE	2564.01	211.64	149.17	48.00	3134.32
PLAN RESRCH	NYSE	135.34	3.01	3.16	5.79	69.10
PLAYBOY ENT	NYSE	197.73	1.10	0.95	4.40	158.70
PROLER INTL	NYSE	129.97	24.68	18.02	0.59	70.13
PUGET P&L	NYSE	142.39	21.39	8.00	1.93	621.28
QUAKER ST	NYSE	292.91	23.19	22.25	0.00	214.82
RAMADA INNS	NYSE	212.47	1.02	-3.63	0.00	485.37
RANCO INC	NYSE	95.06	-1.35	0.34	5.50	72.94
RAYTHEON CO	NYSE	2245.44	70.57	50.93	52.69	1030.65
READNG &BAT	NYSE	190.77	26.32	8.88	5.20	345.78
REVERE COPR	NYSE	382.06	-31.28	-15.98	6.60	457.51
RORER-AMCHM	NYSE	272.09	29.08	27.76	4.50	226.36
ROYAL CROWN	NYSE	257.45	13.29	12.40	4.60	112.56
SAVANNAH EL	NYSE	62.49	6.30	2.15	0.43	179.18
SAVIN BUS	NYSE	52.00	1.65	1.58	1.11	43.72
SCOA INDS	NYSE	501.79	8.24	7.46	12.00	138.59
SCOTT &FETZ	NYSE	284.02	17.05	15.74	7.08	184.18
SIERRA PACF	NYSE	98.07	9.48	4.43	0.92	307.71

SIMMONS CO	NYSE	434.35	10.27	10.99	0.00	260.64
SKYLINE CP	NYSE	179.18	2.77	2.99	2.78	91.13
SOUTHN NE T	NYSE	479.98	44.94	35.81	13.10	1198.64
STERNDENT	NYSE	113.49	3.24	2.62	1.10	61.25
STOKELY-VAN	NYSE	484.26	10.86	9.43	16.00	239.11
STONE & WEB	NYSE	138.71	26.73	22.63	0.00	193.04
STORER BRD	NYSE	101.15	10.84	10.88	1.60	165.30
STRIDE RITE	NYSE	83.95	5.12	4.65	3.60	48.91
SUN OIL CO	NYSE	4389.12	220.05	386.35	27.85	4383.51
SUNSHNE MIN	NYSE	59.95	5.04	3.48	1.68	58.70
SWANK INC	NYSE	81.37	5.25	4.77	0.00	55.94
TALCOT NATL	NYSE	0.49	-4.46	-1.49	0.00	90.57
TALLEY INDS	NYSE	321.58	8.73	7.06	9.00	210.78
TAMPA ELEC	NYSE	183.40	21.22	7.47	2.09	667.64
TELEX CORP	NYSE	101.69	1.00	0.56	2.05	90.41
TRANSWY INT	NYSE	516.03	18.05	6.24	0.00	208.72
TRAVELERS	NYSE	4569.00	127.80	6.80	0.00	9841.50
UGI CORP	NYSE	158.53	9.62	7.73	0.00	251.93
UNION CORP	NYSE	123.04	3.28	3.74	2.90	86.65
UNION O-CAL	NYSE	5086.42	232.75	238.10	15.67	3776.12
U.S. FIDELITY & GUARANT	NYSE	949.47	36.45	-2.69	7.96	1874.25
UNITRODE CP	NYSE	31.93	2.00	2.02	1.28	24.54
UPJOHN CO	NYSE	890.77	66.75	50.70	17.60	874.24
USM CORP	NYSE	686.04	20.98	18.72	24.80	604.32
UTD ILLUM	NYSE	188.65	21.56	-3.51	1.45	458.62
UTD REFIN	NYSE	307.54	5.55	5.56	0.00	120.83
UV INDS	NYSE	427.25	24.38	19.94	11.74	446.71

CLIENTS OF COOPERS AND LYBRAND--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
VA ELECBPWR	NYSE	1033.34	154.73	27.38	7.90	3871.81
VARIAN ASC	NYSE	310.44	7.71	7.11	9.99	245.68
VIACOM INTL	NYSE	39.38	3.10	2.24	0.00	105.99
WASHGTN STL	NYSE	61.68	2.90	2.58	0.83	62.14
WEIS MRKTS	NYSE	369.35	15.37	15.58	5.00	104.46
WESTN PUBL	NYSE	224.81	10.20	9.09	4.54	163.15
WHITTAKR CP	NYSE	663.32	7.78	4.82	12.60	508.91
WICKES CORP	NYSE	1120.78	14.89	15.48	12.82	489.01
WORLD AIR	NYSE	97.70	5.24	-1.29	0.00	182.08
ZAYRE CORP	NYSE	1052.84	0.83	0.41	26.50	345.44
AIRPAX ELEC	AMSE	17.34	1.04	0.90	0.69	12.27
ALCCLAC INC	AMSE	26.57	1.99	2.03	0.36	12.39
AM INTL PIC	AMSE	46.93	2.85	2.57	0.38	28.64
AM MAIZE	AMSE	234.60	14.61	14.27	3.25	118.20
AMCC INDUSTRIES	AMSE	142.90	2.19	2.17	0.28	29.19
ANIXTER BRC	AMSE	154.63	7.01	7.10	1.38	68.68
AVX CORP	AMSE	26.96	0.86	0.64	0.00	17.43
BINNEY & SM	AMSE	56.04	4.41	5.06	0.00	43.84
BLOUNT INC	AMSE	370.35	4.14	3.46	8.03	152.39
BOLT BERNEK	AMSE	28.69	1.27	1.30	0.77	15.21
BROWN FORMN	AMSE	183.40	19.05	19.20	2.03	265.27
CAMPBL INDS	AMSE	79.54	2.86	3.19	0.00	30.19

CARESSA INC	AMSE	45.00	2.85	2.30	0.15	19.08
CARROL DEVL	AMSE	63.91	-0.85	-0.28	4.64	30.83
CHEM EXPRES	AMSE	35.71	0.12	-0.19	1.40	33.47
CITIZENS FIN CORP.	AMSE	18.02	-19.44	-0.70	0.22	179.62
COIT INTERNA, INC.	AMSE	101.47	-15.59	-6.73	3.66	65.51
COMBUSTN EQ	AMSE	115.98	5.98	5.35	2.60	111.75
COMPUDYNE	AMSE	39.28	0.74	0.60	1.00	24.40
CONROCK CO	AMSE	71.09	2.88	1.52	0.00	54.28
CONS OIL	AMSE	17.10	4.98	0.57	0.15	78.36
CONT MATRLS	AMSE	14.70	0.13	0.04	0.34	16.93
CORRN-BLACK	AMSE	35.08	3.60	4.98	0.00	97.55
CSE CORP.	AMSE	22.43	2.45	0.98	0.22	36.83
CURTIS MATH	AMSE	32.02	0.09	0.15	0.90	16.54
DATA CONT SYS, INC.	AMSE	5.48	-1.47	0.00	0.17	3.70
DCL INC	AMSE	18.67	-10.71	0.00	0.04	37.54
E L T INC	AMSE	53.31	4.24	3.30	0.88	38.68
EARTH RESUR	AMSE	230.86	10.38	9.69	1.50	90.08
EASTN CO*	AMSE	43.44	2.64	2.13	0.87	24.63
EGAN MACH	AMSE	24.62	0.89	0.64	0.35	15.75
FLYING DIAM	AMSE	9.44	3.72	-0.10	0.00	52.25
GILBERT COMPANIES, THE	AMSE	8.59	0.07	0.05	0.25	3.27
GLENMR DIST	AMSE	67.51	0.65	0.51	0.96	95.58
GRAND CENT	AMSE	128.60	1.59	1.14	2.42	30.68
GRT AM INDS	AMSE	34.62	1.67	1.60	1.17	19.58
GRT LK REC	AMSE	5.39	0.13	0.16	0.28	7.73
GRUEN INDS*	AMSE	14.85	-2.78	-0.04	0.25	12.55
HEINCK INST	AMSE	7.32	0.71	0.52	0.18	8.85

CLIENTS OF COOPERS AND LYBRAND--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
HOUSE-VISN	AMSE	34.96	1.02	0.92	1.16	16.64
INOLEX CORP	AMSE	56.44	-2.26	0.00	0.00	29.67
IONICS INC	AMSE	17.19	0.66	0.61	0.41	13.43
JEANETTE CP	AMSE	42.84	2.35	1.96	0.00	26.72
KIT MFG	AMSE	32.02	-0.47	0.00	0.80	12.08
LANE WOOD	AMSE	0.00	0.00	0.00	0.00	0.00
LATOUR-BICK	AMSE	8.18	0.28	0.24	0.00	8.36
MACRODYNE	AMSE	39.43	-12.67	0.00	0.98	19.44
MANHATTAN LIFE CORP.	AMSE	84.37	1.53	2.39	0.39	416.16
MAULE INDS	AMSE	79.28	2.58	0.97	1.50	189.77
MILGO ELEC	AMSE	39.74	4.25	1.29	1.60	53.41
MITE CORP	AMSE	42.27	3.72	4.03	0.95	36.05
MOAMCO CORP.	AMSE	2.52	-1.41	0.23	0.03	7.84
N H BALL BR	AMSE	20.84	1.17	1.01	1.07	17.39
KELLY DON	AMSE	12.64	-0.30	-0.28	0.82	7.27
NEWCOR INC	AMSE	20.36	1.44	1.66	0.40	10.75
ON-LINE SYS	AMSE	11.18	1.25	1.10	0.19	15.17
OXFORD FST	AMSE	4.67	0.07	0.08	0.00	72.77
PAC NW BELL	AMSE	734.02	89.43	68.87	0.00	1870.49
PANDL-BRAD	AMSE	42.01	0.43	0.27	0.58	20.05
PRATT READ	AMSE	31.59	1.21	1.05	1.49	18.95
PUNTA GORDA	AMSE	13.87	0.68	0.72	0.00	111.03

PUTNAM'S (G.P.) SONS	AMSE	21.30	1.46	1.33	0.27	14.68
RESRCH-COTT	AMSE	223.65	2.36	2.57	2.43	128.95
REX-NORECO	AMSE	3.19	-3.32	-0.25	0.04	17.49
RIO ALGOM	AMSE	390.57	43.82	35.60	5.36	472.31
ROCKWD COMPUTER CORP*	AMSE	0.00	0.00	0.00	0.00	0.00
ROGERS CORP	AMSE	39.79	0.50	0.07	1.42	32.27
RYAN HOMES	AMSE	194.24	10.43	11.01	1.03	90.07
SAUNDERS L	AMSE	71.79	1.66	0.56	0.00	92.08
SCOPE INDS	AMSE	20.77	1.70	1.75	0.60	15.39
SELIGMN ASC	AMSE	15.56	-1.89	-0.98	0.14	35.72
SGL INDS	AMSE	26.77	1.11	1.09	0.00	15.42
SHEARSN HAY	AMSE	125.08	4.43	4.62	3.30	357.55
SPLENTEX*	AMSE	15.95	0.87	-0.30	1.02	10.53
STELBER INDUS, INC.	AMSE	86.86	-13.16	-1.40	2.00	78.44
SYSTEMS ENG	AMSE	17.46	-0.46	0.20	0.45	13.66
TASTY BAKNG	AMSE	146.15	6.45	6.93	0.00	52.39
TELECOM CP	AMSE	68.07	1.13	0.29	2.79	59.07
TERADYN INC	AMSE	37.87	0.38	0.19	1.12	31.23
TFI COS	AMSE	131.82	1.74	1.91	0.95	59.85
TOKHEIM CP	AMSE	58.61	2.51	2.40	1.45	37.72
TURNR CONST	AMSE	769.49	3.49	3.94	1.27	112.09
U S NAT RES	AMSE	44.26	2.22	1.50	0.64	30.87
UTD AIR PRD	AMSE	11.68	0.99	0.96	0.40	9.43
WAGNER ELEC	AMSE	285.05	1.63	1.54	6.10	176.98
WELDED TUBE	AMSE	65.73	7.38	7.00	0.33	44.60
WORCES CNTR	AMSE	46.14	2.82	2.77	1.18	32.90
WYOMISSING	AMSE	17.81	0.26	0.25	0.76	14.77

CLIENTS OF HASKINS AND SELLS

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
A J INDS	NYSE	59.31	3.14	4.85	1.13	38.84
AIRCO INC	NYSE	765.66	42.67	39.09	13.18	714.68
ALD SUPR	NYSE	1044.08	-3.43	-0.87	13.00	165.96
ALPHA PCFT	NYSE	176.31	-1.98	-2.64	2.10	146.35
AM ELEC PWR	NYSE	1644.22	239.76	14.89	18.39	6408.28
AM INVEST	NYSE	142.68	-0.60	0.64	0.00	536.29
AMBAC INDS	NYSE	187.86	9.41	9.24	5.13	146.69
AMFAC INC	NYSE	1133.82	38.50	33.00	23.10	738.47
ARISTAR INC	NYSE	91.37	-6.23	-0.68	3.50	379.07
ARIZ P SERV	NYSE	359.75	56.50	0.00	3.73	1228.86
ARMCO STEEL	NYSE	3046.74	116.66	55.39	48.82	2605.97
ATLANTC CTY	NYSE	199.08	28.28	8.69	1.76	609.37
BAKER OIL TOOLS,INC	NYSE	372.26	35.68	29.25	8.58	301.47
BANK OF NY	NYSE	318.93	33.39	13.01	0.00	4508.86
BEARNGS INC	NYSE	180.32	9.38	9.84	1.94	80.38
BENDIX CORP	NYSE	2589.70	79.80	48.30	74.10	1567.60
BENEFICIAL	NYSE	452.54	70.37	41.93	29.30	2434.97
BLUE BELL	NYSE	568.64	25.78	20.17	24.00	302.39
BRANIF INTL	NYSE	598.86	20.39	6.54	10.70	533.60
BUNKER RAMC	NYSE	289.06	-13.84	-1.40	0.00	246.12
BURLNGTN NO	NYSE	1595.22	52.94	14.22	46.54	3278.88
CARO P & L	NYSE	606.33	101.62	42.60	4.74	2402.02

CASTLE &CKE	NYSE	843.05	38.16	28.78	35.26	660.45
CHRIS-CRAFT*	NYSE	61.15	-3.10	-3.05	1.93	131.58
CITZN-SC RL	NYSE	39.82	-58.64	0.00	0.00	435.78
CLOROX CO	NYSE	721.50	21.15	23.49	6.20	265.16
CLUETT PEAB	NYSE	519.35	11.96	9.27	24.40	277.51
COMMUN SATL	NYSE	142.58	46.24	41.33	1.32	466.62
COMWLTH OIL	NYSE	801.53	-24.63	0.81	0.00	573.49
CONT CAN CO	NYSE	3101.90	107.20	67.20	59.88	1963.10
COPPERWD CP	NYSE	282.98	18.44	16.65	3.57	176.18
COX BRDCST	NYSE	110.25	14.30	13.58	0.00	167.66
DEERE & CO	NYSE	2955.20	179.07	103.70	53.79	2440.83
DELTONA CP	NYSE	73.44	-5.08	-5.69	2.30	340.16
DIAMND INTL	NYSE	779.07	49.19	40.40	0.00	531.17
DOW CHEMICL	NYSE	4888.11	615.66	475.30	53.10	5846.73
DUKE POWER	NYSE	954.41	128.24	97.40	11.81	3740.80
DUQUESNE LT	NYSE	405.12	71.52	35.46	0.00	1593.28
ECKERD DRUG	NYSE	198.60	6.35	6.27	4.44	59.36
EMHART CORP	NYSE	336.04	19.66	13.09	12.56	279.74
ENVIROTECH	NYSE	364.66	6.86	4.93	8.60	241.20
EQUIT L MTG	NYSE	33.96	10.36	0.00	0.01	351.59
FALSTAFF BREWING CORP	NYSE	188.38	-3.87	0.23	2.82	89.00
FED PAPRBRD	NYSE	333.69	16.63	12.80	7.00	290.51
FILTROL CP	NYSE	64.23	5.54	2.81	1.16	60.44
FISCHBCH-MC	NYSE	607.32	10.42	10.05	12.00	235.01
FLA PWR&LGT	NYSE	1182.64	145.22	107.57	9.80	3416.94
FOREMOST MC	NYSE	2378.34	34.73	31.67	17.50	825.09
GAF CORP	NYSE	964.42	30.95	15.56	20.23	705.43

CLIENTS OF HASKINS AND SELLS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
GARLOCK INC.	NYSE	151.17	6.43	6.91	5.87	112.98
GEN MOTORS	NYSE	5724.91	1253.09	1118.20	681.00	1664.91
GRT A&P TEA	NYSE	6874.61	-157.07	-11.20	105.00	1020.71
GULF LIFE	NYSE	243.48	30.82	10.73	0.00	909.48
HOBART CORP	NYSE	393.82	19.29	16.90	11.50	298.02
HOLLY SUGAR	NYSE	275.16	29.93	31.20	3.17	160.73
HOMESTK MIN	NYSE	116.83	24.23	8.75	2.06	153.42
HONEYWELL	NYSE	2760.07	76.48	44.15	83.05	2573.91
HOST INTL	NYSE	208.51	-0.51	-1.78	0.00	109.86
HOUDAILLE	NYSE	291.52	17.36	14.35	6.60	189.66
HOUSE-FABRC	NYSE	97.77	4.27	4.39	4.03	61.34
HOUSHLD FIN	NYSE	526.78	109.50	47.35	0.00	3211.87
HOUSTON L&P	NYSE	634.15	70.89	51.95	0.00	2003.46
HOUSTON NAT	NYSE	819.75	69.65	34.26	0.00	807.64
HUGHES TOOL	NYSE	347.98	43.42	31.60	8.30	377.51
IDAHO PWR	NYSE	121.32	20.64	11.34	1.40	740.48
IDEAL BASIC	NYSE	268.63	28.45	17.60	3.85	356.31
INDPLS P&L	NYSE	177.88	26.54	14.92	0.00	712.40
INTEGON CORP.	NYSE	123.41	5.94	2.67	0.72	374.15
INTL HARVST	NYSE	5246.04	115.92	59.73	104.17	3510.34
INTRST POWR	NYSE	103.69	10.05	5.21	1.02	289.25
JANTZEN INC	NYSE	115.23	4.78	4.35	4.13	64.91

KAISER ALUM	NYSE	1578.12	94.71	33.00	23.26	2101.76
KAUFMN &BRD	NYSE	292.62	-0.82	7.43	2.30	627.77
KAWECKI BER	NYSE	77.26	-1.06	-3.38	0.00	116.36
KIMBRLY-CLK	NYSE	1483.74	102.54	71.93	27.81	1305.24
LACLEDE GAS	NYSE	203.38	12.67	10.93	2.16	272.63
LEASEWY TRN	NYSE	489.89	21.66	14.30	0.00	432.45
LIGGETT&MYR	NYSE	675.99	35.94	34.67	6.80	642.20
LONE STAR GAS CO.	NYSE	509.93	54.49	28.24	6.81	954.94
LONG DRUG	NYSE	339.57	12.07	13.07	3.50	82.12
LOWENSTEIN	NYSE	467.96	-5.89	-5.03	16.35	351.07
LUBRIZOL CP	NYSE	419.09	46.89	35.86	3.59	305.38
MACMILN INC	NYSE	477.35	13.06	13.19	18.25	451.12
MAGIC CHEF	NYSE	188.28	-1.82	-0.20	3.60	128.73
MAPCO INC	NYSE	342.18	49.31	39.98	2.20	434.19
MAYS J W	NYSE	162.62	-0.25	-0.60	5.80	57.45
MCCRORY CORP.	NYSE	1281.70	-37.09	5.24	42.70	492.20
MERRIL LYNC	NYSE	953.22	95.69	101.34	19.25	4879.01
MFRS HAN	NYSE	1857.69	136.38	99.78	17.69	8290.51
MID SO UTIL	NYSE	923.02	102.86	47.89	0.00	3634.62
MINN MIN&MF*	NYSE	3127.34	261.62	195.00	78.43	3016.76
MONOGRM INC	NYSE	187.95	7.80	5.32	3.80	151.52
MONSANTO CO	NYSE	3624.70	306.30	230.00	59.24	3450.90
MORGAN JP	NYSE	1960.94	191.89	163.51	9.81	5832.41
NATL AIRL	NYSE	345.29	11.35	1.64	7.70	547.62
NOR ST PWR	NYSE	675.36	91.12	62.58	6.56	2206.34
NORLIN CORP	NYSE	213.68	8.58	8.28	6.49	168.35
NORRIS INDS	NYSE	387.40	17.99	18.54	9.00	196.02

CLIENTS OF HASKINS AND SELLS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
NORTON SIMN	NYSE	1696.40	79.29	63.93	26.00	1355.72
OGDEN CORP	NYSE	1491.26	47.03	20.62	46.40	925.95
OMARK INDS	NYSE	125.97	11.75	6.30	3.51	128.95
ONEIDA LTD	NYSE	100.41	2.89	2.23	3.12	75.35
PAC G & E	NYSE	2233.37	251.58	4.91	24.99	6620.88
PAC LT CORP	NYSE	1098.28	49.36	20.11	9.14	1662.83
PAC P & L	NYSE	301.49	72.44	-0.64	0.00	1834.74
PALM BEACH	NYSE	117.70	3.03	3.18	5.50	70.44
PENN CEN.TRANS CO.	NYSE	2247.26	-198.02	0.00	78.75	4271.43
PENN P&L	NYSE	544.13	97.54	39.08	6.70	2311.88
PHILIP INDS	NYSE	178.51	-5.01	-1.49	3.46	104.02
PIEDMNT NAT	NYSE	80.40	6.43	5.25	0.79	132.54
PPG INDS	NYSE	1886.60	89.00	56.80	34.90	1869.00
PROCTR & GM	NYSE	6081.67	333.86	287.77	51.00	3652.67
PS E & G	NYSE	1630.52	158.61	54.37	13.35	4473.47
PUERTO RICN	NYSE	55.58	-3.41	-2.51	1.13	97.50
RAPID-AMER	NYSE	2560.00	-18.68	-9.52	69.75	1776.76
REXHAM CORP	NYSE	84.89	3.03	2.89	1.78	54.62
RIO GRANDE	NYSE	186.31	14.29	7.09	0.00	406.45
ROBRTSN H H	NYSE	343.97	12.78	15.17	7.13	194.76
ROCKWEL INT	NYSE	4943.40	101.60	73.70	122.79	2888.10
S DIEGO G&E	NYSE	374.25	25.72	-0.03	4.03	1010.17

S JERSY IND	NYSE	73.43	3.84	0.80	0.00	112.14
SABINE ROYL	NYSE	38.47	10.37	8.45	0.00	93.18
SCHR-PLOUGH	NYSE	793.27	138.89	71.60	16.00	767.59
SCM CORP	NYSE	1287.45	27.89	14.18	26.30	704.08
SE BANKING	NYSE	235.46	12.91	-3.98	0.00	3249.91
SEABRD C LN	NYSE	1420.90	97.87	25.66	41.30	2594.39
SEDCO INC	NYSE	226.76	37.59	10.68	8.10	474.76
SIGNAL COS	NYSE	2141.95	41.42	32.25	40.80	1866.82
SO CARO E&G	NYSE	321.13	38.42	24.98	0.00	1005.63
SOO LINE RR	NYSE	179.79	14.31	9.30	5.16	317.81
SOUTHN PAC	NYSE	1647.32	74.93	37.05	43.30	3724.47
SPRINGS MIL	NYSE	543.09	10.69	9.52	19.40	410.84
ST JOE MINL	NYSE	729.38	81.67	50.75	0.00	555.94
ST REGIS	NYSE	1394.75	95.91	57.42	28.00	1394.24
STALEY A E	NYSE	776.79	50.36	50.23	3.76	347.95
STANDEX INT	NYSE	175.69	5.38	4.59	0.00	127.79
STAUFFR CHM	NYSE	949.84	98.71	64.00	13.08	966.70
TEKTRONIX	NYSE	336.64	26.33	20.50	12.66	306.62
TEXFI INDS	NYSE	183.68	-8.33	-6.54	5.03	165.87
TRANS WORLD	NYSE	2640.12	-86.28	-17.18	78.60	1929.45
TRANSCON LN	NYSE	133.91	2.37	1.26	4.01	76.77
TUCSON G&E	NYSE	166.83	27.64	5.58	1.39	599.98
U S LEASING	NYSE	67.85	7.82	6.47	0.79	397.39
UNION CAMP	NYSE	835.93	88.73	68.35	14.11	826.13
UNION PACIF	NYSE	1755.31	148.62	38.96	28.19	3418.25
UNIROYAL	NYSE	2187.64	23.04	15.13	55.54	1605.87
UTAH P&L	NYSE	212.44	39.18	9.53	2.65	967.71

CLIENTS OF HASKINS AND SELLS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
VETCO OFFSH	NYSE	127.07	17.32	10.93	2.03	129.92
VULCAN MAT	NYSE	360.02	27.74	17.79	5.53	325.76
WASH WATER	NYSE	134.90	17.49	4.43	1.11	441.96
WATKN-JHNSN	NYSE	76.83	7.17	5.90	2.27	57.73
WELLS,RICH,GREENE,INC.	NYSE	28.63	3.21	2.97	0.59	38.43
WITTER D	NYSE	175.86	12.31	13.29	4.70	352.88
WOMETCO ENT	NYSE	165.34	11.62	7.44	5.45	155.08
WURLITZR CO	NYSE	82.24	-0.07	1.19	3.00	76.41
AIKEN INDS	AMSE	29.57	1.23	1.08	1.18	20.14
AJAX MAGNETHERMIC CORP.	AMSE	35.54	3.40	3.23	0.75	24.59
AM BUS PDS	AMSE	68.99	2.06	1.73	1.83	32.84
AM MFG CO	AMSE	26.19	10.86	1.02	0.00	102.31
AM TECH INC	AMSE	21.21	0.16	0.12	0.79	13.54
AMPEX CP	AMSE	241.72	9.83	9.20	10.00	261.71
ARMAC ENTERPRISES, INC.	AMSE	27.43	-6.83	-3.91	0.28	33.19
ASTRODATA, INC.	AMSE	10.28	-10.56	0.42	0.25	6.97
ATCO INDS	AMSE	15.90	0.06	0.05	0.28	7.86
AUGAT INC	AMSE	28.48	3.03	2.80	0.00	24.55
AUTOMC RAD	AMSE	52.23	0.25	0.79	1.25	42.22
AUTOMC SWIT	AMSE	70.69	6.01	5.65	0.00	59.69
AUTOMD BLDG	AMSE	23.13	0.44	0.37	0.46	19.90
AYDIN CORP*	AMSE	32.57	1.65	1.31	0.95	16.08

BEHAVIORAL RES LABS,INC.	AMSE	7.26	0.75	0.00	0.89	4.61
BENRUS CORP	AMSE	36.83	0.96	1.19	1.05	35.87
BERGEN BRUN	AMSE	351.82	2.82	2.08	3.47	95.03
BIC PEN	AMSE	74.45	6.20	5.80	1.25	60.60
BRADFD CMPT	AMSE	62.15	4.04	4.30	0.00	279.26
BREEZE CORP	AMSE	14.77	-0.14	-0.01	0.53	10.35
CALIF LIFE	AMSE	30.94	0.84	0.00	0.00	45.15
CALIF PCPT	AMSE	81.18	4.27	0.38	1.30	153.73
CELLU-CRAFT	AMSE	28.20	0.35	0.51	0.60	14.87
CLARKSN INC	AMSE	29.54	1.25	1.55	0.47	21.36
COMPTR INST	AMSE	5.15	0.05	0.04	0.23	2.83
CORDON INTL	AMSE	46.93	0.66	0.39	0.00	46.19
COX CABLE	AMSE	29.31	2.85	2.82	0.77	66.14
DELTA OF AM	AMSE	5.24	-2.91	0.41	0.00	14.14
DESERET PHR	AMSE	28.72	2.60	2.22	1.16	29.61
DIAL FIN CP*	AMSE	89.56	7.70	6.40	1.80	363.66
DIGICON INC	AMSE	26.10	2.04	1.71	0.67	39.99
ELCO INDUSTRIES, INC.	AMSE	50.26	2.22	1.55	1.29	32.09
ELECTRGRPHC	AMSE	28.47	0.80	0.81	0.00	14.67
EMPRESS INTERNATL, LTD	AMSE	20.01	0.18	0.17	0.06	5.75
GALAXY CRPT	AMSE	55.75	0.79	0.68	1.00	32.83
GLATFELT PH	AMSE	79.55	8.53	7.93	0.00	99.91
GOLDEN CYCL	AMSE	78.03	0.66	0.49	1.10	59.23
HARLAND J H	AMSE	44.00	4.23	4.17	0.00	25.67
HAWAII AIRL	AMSE	53.08	2.34	1.04	1.35	34.85
HORN & HARD	AMSE	48.38	0.07	0.11	0.00	26.27
HUDSN GEN	AMSE	34.01	-2.61	0.07	1.15	47.77

CLIENTS OF HASKINS AND SELLS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
IPCC HOSPTL	AMSE	145.46	1.74	0.83	3.25	84.12
KAN G & E	AMSE	126.17	18.45	11.77	1.29	483.07
LEE PHARM	AMSE	3.91	-0.13	-0.28	0.12	6.31
LOEWS THEATRES,INC.	AMSE	596.37	45.28	14.20	11.66	1273.88
MAINE P S	AMSE	16.94	1.45	1.03	0.20	40.99
MAUL BROS	AMSE	17.32	0.73	0.66	0.65	22.50
MIDLAND CO	AMSE	81.65	-0.28	-0.67	0.00	273.07
MPS INTERNATIONAL CORP.	AMSE	29.16	-0.63	0.13	0.26	12.24
MT VERNON	AMSE	57.27	1.04	-0.06	4.00	55.35
N Y TIMES	AMSE	408.88	12.75	8.43	6.60	240.69
PENN ENGINE	AMSE	10.76	1.21	1.30	0.00	12.17
PERMANEFR*	AMSE	49.55	-15.72	-1.23	1.80	55.59
PRATT LMBRT	AMSE	70.21	1.73	1.47	1.20	34.16
PRENTICE-HL	AMSE	194.00	19.55	19.49	0.00	152.00
PRESIDL RLT	AMSE	34.61	-6.88	-1.57	0.00	134.60
ROSSMOOR	AMSE	38.60	-9.38	-6.60	0.27	76.16
ROWAN COS	AMSE	64.74	15.80	2.01	0.00	122.61
RUDDICK CP	AMSE	232.57	1.32	0.76	5.51	73.54
SATURN AIRW	AMSE	65.91	5.34	3.62	0.64	70.47
SCHENUIT	AMSE	36.62	1.24	1.15	0.72	20.13
SEARS INDS	AMSE	100.78	-0.80	-1.61	5.20	70.98
SHAER SHOE	AMSE	6.93	0.34	0.32	0.33	6.12

SORG PAPER	AMSE	42.60	-1.29	-1.61	0.59	23.61
SPENCER FD	AMSE	444.31	1.79	0.84	1.79	52.65
STARRET HSG	AMSE	131.81	2.83	3.54	0.64	62.11
STD COOSA	AMSE	75.43	0.06	-0.11	3.60	56.57
SYNTEX CORP	AMSE	245.86	46.13	7.83	6.05	398.53
TEXAS POWER & LIGHT CO.	AMSE	316.07	66.29	24.95	3.61	1213.35
WADEL EQUIP	AMSE	3.03	0.08	0.05	0.09	3.92
WELLCO ENT	AMSE	11.65	0.22	0.07	0.61	8.29
WESTERN FINANCIAL CORP.	AMSE	71.50	3.33	1.11	1.99	917.14
WICHITA IND	AMSE	2.95	0.57	0.26	0.02	3.08
WILLCOX-GIE	AMSE	50.06	-1.54	0.13	1.85	61.67
WRATHER CORP.	AMSE	19.73	-1.22	-1.30	0.80	39.71
WUI INC	AMSE	80.58	6.60	3.91	2.70	150.39
YATES INDS	AMSE	19.01	-0.68	-0.56	0.44	36.95
ZERO MFG CO	AMSE	34.97	1.55	1.95	0.95	20.16
ZIMMER HOME	AMSE	35.14	0.74	0.43	0.55	17.02

CLIENTS OF PEAT, MARWICK, MITCHELL & CO.

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
INVESTORS DIV. SERV.	AMSE	265.28	23.25	-4.48	3.03	1717.59
ADAMS DRUG	NYSE	121.03	1.57	1.79	3.95	52.70
AETNA LIFE	NYSE	6072.33	101.66	2.52	0.00	5464.40
AGUIRRE CO	NYSE	14.95	0.21	0.16	0.18	24.47
AHMANSON HF	NYSE	561.99	43.61	22.60	0.00	6496.56
ALASKA INTS	NYSE	162.18	7.68	1.95	0.00	205.30
ALBERTO-CLV	NYSE	145.30	1.59	1.12	2.20	73.86
ALLEG LUDLM	NYSE	791.98	30.08	16.83	16.78	638.26
ALLEGHANY CORP.	NYSE	84.61	43.54	3.68	0.00	254.02
AM AIR FLTR	NYSE	249.39	7.54	6.59	5.10	183.63
AM BRDCST	NYSE	1064.65	17.10	18.63	0.00	697.81
AM CYANAMID	NYSE	1928.44	147.68	100.60	37.82	1722.17
AM STORES	NYSE	2734.71	19.32	17.15	39.00	466.84
AMERICAN FAMILY CORP.	NYSE	67.46	10.06	2.82	0.45	104.12
ANDRSN CLTN	NYSE	878.90	31.52	22.87	16.90	412.31
APCO OIL CP*	NYSE	287.95	-2.08	-3.31	0.00	198.54
ARMSTRNG CK	NYSE	859.41	34.92	25.70	22.51	730.72
ATHLON INDS	NYSE	230.48	11.67	11.76	0.00	158.67
AZTEC OIL AND GAS CO.	NYSE	16.73	6.81	0.45	0.07	88.57
BAKER INDS	NYSE	136.07	6.81	5.35	11.39	107.53
BALDWIN D.H. & CO.	NYSE	57.45	5.64	2.42	4.80	1104.26
BANGOR PUNT	NYSE	256.06	9.42	6.60	5.62	234.90

BATES MFG	NYSE	147.06	7.82	9.50	0.00	71.45
BEATRC FOOD	NYSE	4191.76	134.76	126.00	64.00	1658.17
BORG-WARNER	NYSE	1639.00	44.50	21.00	37.70	1192.50
BT MTGE INV	NYSE	10.96	-22.42	0.00	0.00	167.17
BUDD CO	NYSE	862.89	10.91	3.78	22.00	553.56
BUDGET INDS*	NYSE	56.00	-1.15	-1.05	0.00	465.15
BULOVA WTCH	NYSE	228.17	2.33	0.61	7.30	267.35
BURLNGTN IN	NYSE	1958.09	39.77	34.90	71.00	1566.52
CADENCE	NYSE	88.15	1.18	1.41	0.00	90.16
CARLISLE CP	NYSE	115.01	2.20	1.88	3.23	81.18
CARTER-WALL	NYSE	151.72	8.40	5.28	3.00	155.16
CCI CORP*	NYSE	111.96	-0.60	0.65	2.41	80.26
CELANESE CP	NYSE	1900.00	50.00	28.00	37.00	1908.00
CENTL MA PW	NYSE	146.40	13.81	7.30	1.95	424.86
CH MNTN MTG	NYSE	71.64	-166.45	0.00	0.00	850.99
CHAMP SPARK	NYSE	458.20	46.74	48.44	13.00	402.22
CHARTER CO	NYSE	1118.51	40.83	79.90	4.02	419.88
CHARTER NY	NYSE	708.96	45.09	19.87	7.60	1106.60
CHASE MAN	NYSE	3231.69	156.64	70.35	30.12	1413.61
CHEMETRN CP	NYSE	464.27	30.37	28.85	9.20	371.31
CHESSIE SYS	NYSE	1289.03	85.39	7.43	38.40	2816.67
CHICAGO,MILWAUKEE CORP.	NYSE	466.17	11.27	2.48	15.17	834.79
CHOCK FL-NT	NYSE	137.34	-0.03	-1.19	2.74	61.07
CHROMALLOY	NYSE	791.40	21.71	15.99	0.00	565.44
CI MTG GRP	NYSE	34.24	-10.42	0.00	0.00	372.50
CITICORP	NYSE	4936.57	348.20	263.19	44.60	7849.71
CITIES SERV	NYSE	3200.70	137.70	99.40	17.10	3233.50

CLIENTS OF PEAT, MARWICK, MITCHELL & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
CITY INVEST	NYSE	2132.57	39.16	9.33	36.00	3759.91
CLC OF AMER	NYSE	114.98	6.22	4.32	1.60	149.39
COLNIAL STR	NYSE	982.00	13.37	10.00	0.00	174.09
CON AGRA*	NYSE	573.54	4.07	0.53	4.20	126.31
CONT AIRL	NYSE	457.27	8.11	3.11	9.01	711.40
CONTINENTAL CORP. (THE)	NYSE	1798.18	60.36	-19.72	19.71	4079.26
CONTRL DATA	NYSE	1218.24	40.71	18.39	42.81	1822.82
CONWOOD CP	NYSE	79.26	6.48	6.57	1.30	59.20
COOPER LABS	NYSE	88.26	2.03	1.31	2.60	88.51
CREDITHRIFT	NYSE	165.40	3.02	-1.26	2.86	722.86
CROMPTN KNW	NYSE	118.58	3.29	1.78	2.20	83.40
DAN RIVER	NYSE	404.38	-2.95	-6.41	18.00	308.40
DIAL FIN CP*	NYSE	89.56	7.70	6.40	1.80	363.66
DILLNGHM CP	NYSE	913.16	18.10	12.10	0.00	631.32
DILLON COS	NYSE	969.23	17.65	14.69	13.60	175.24
DONALDSN LU	NYSE	50.45	-11.47	-5.59	0.88	236.54
DOVER CORP	NYSE	326.36	24.49	24.77	8.10	189.86
DPF INC*	NYSE	22.54	0.38	0.26	0.10	54.10
DR PEPPER	NYSE	138.25	11.90	11.23	0.00	58.39
EAGLE-PICHR	NYSE	347.08	18.68	16.40	8.20	218.69
ECKERD JACK	NYSE	555.34	24.86	23.55	11.44	211.22
EMERSN ELEC	NYSE	1250.30	96.19	85.70	34.00	850.96

ENNIS BUS	NYSE	58.92	3.58	3.40	1.80	29.61
EX-CELL-O	NYSE	423.54	19.96	16.41	10.87	311.36
FABERGE CP	NYSE	180.59	3.17	1.86	3.00	166.73
FAIRMT FOOD	NYSE	461.23	6.15	5.29	8.28	144.07
FARAH MFG	NYSE	151.59	1.40	0.60	8.00	100.58
FERRO CORP	NYSE	323.73	15.19	10.81	7.62	212.29
FIDELITY UN	NYSE	109.60	16.51	-0.18	0.00	1496.68
FMC CORP	NYSE	2291.93	108.17	43.40	46.57	1843.87
FST MISS CP	NYSE	198.66	41.77	40.08	0.79	199.87
FST PEN MTG	NYSE	15.65	-18.99	0.00	0.00	178.93
FST PENN CP	NYSE	552.12	18.27	-17.85	6.94	7066.81
FST WISC CP	NYSE	245.42	11.50	4.08	4.29	3645.64
GAMBLE-SKOG	NYSE	1487.45	24.99	23.29	18.80	649.21
GANNETT CO	NYSE	345.08	38.55	36.40	12.33	331.20
GEN BANCSHR	NYSE	53.75	5.19	1.69	1.10	697.88
GEN CABLE*	NYSE	326.63	21.66	11.06	5.20	341.48
GEN ELECTRC	NYSE	3399.10	580.80	358.00	375.00	9763.50
GEN MILLS	NYSE	2308.90	76.21	70.65	47.97	1205.63
GEN SIGNAL	NYSE	547.73	24.53	21.84	14.41	367.71
GENESCO INC	NYSE	1095.97	-14.30	3.79	46.00	507.42
GILLETTE CO	NYSE	1406.91	79.95	67.00	33.50	1025.93
GLOBE-UNION	NYSE	261.99	6.66	6.45	8.00	168.14
GORDON JEWL	NYSE	173.33	10.58	9.86	4.35	147.69
GREEN GIANT	NYSE	405.83	8.80	5.89	6.60	263.89
GROLIER INC*	NYSE	248.69	-13.78	-13.63	0.00	309.70
GRT LK DREG	NYSE	56.99	3.70	1.48	0.00	57.04
GRT WST LTD	NYSE	508.44	59.93	62.77	6.72	330.98

CLIENTS OF PEAT, MARWICK, MITCHELL & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
GUARDN MGT	NYSE	47.50	-41.41	0.00	0.00	442.34
HARDEE FOOD	NYSE	162.91	1.54	1.30	7.33	61.92
HAWAII ELEC	NYSE	204.42	19.29	13.92	1.83	539.76
HAYES ALBN	NYSE	160.86	4.72	4.05	4.01	92.96
HEINZ H J	NYSE	1662.70	66.57	49.96	30.00	1144.25
IDS RLTY	NYSE	39.97	-5.10	0.00	0.00	363.65
ILL CENTRAL INDS INC	NYSE	1504.83	48.60	9.84	39.86	2242.70
INDL NATL	NYSE	189.39	12.05	7.99	0.00	2134.32
INTERCO INC	NYSE	1217.89	53.60	51.71	39.40	573.75
INTL MULTFD	NYSE	828.20	14.11	12.83	7.47	295.34
IU INTL CP	NYSE	1814.62	82.18	28.05	35.00	2109.34
KINGS DEPT	NYSE	291.88	8.06	6.64	8.30	76.10
LA LAND	NYSE	291.16	87.73	73.72	0.00	577.61
LENNAR CORP	NYSE	55.21	0.10	0.05	0.39	130.77
LIBRTY LOAN	NYSE	99.23	-14.48	-1.04	3.15	430.45
LONDONTOWN CORP.	NYSE	69.19	2.75	2.93	2.20	36.47
MALLORY P R	NYSE	233.12	3.56	3.84	9.07	158.73
MARION LABS	NYSE	84.10	14.33	13.29	1.48	67.13
MATSUSHITA ELEC. IND.CO.	NYSE	4885.41	180.50	229.71	88.18	4192.07
MELVILLE CP	NYSE	908.32	44.33	33.40	27.65	359.83
MEREDITH CP	NYSE	160.40	6.10	5.59	3.31	135.73
METROMEDIA	NYSE	202.16	6.68	6.28	3.73	254.25

MICH SEAMLS	NYSE	124.67	9.83	9.78	1.66	64.84
MOBILE HOME*	NYSE	60.16	-6.36	-0.78	1.18	60.39
MOHASCO CP	NYSE	560.34	10.25	8.73	16.96	361.67
MONY MTG IN	NYSE	29.37	6.24	0.00	0.00	255.37
MORSE SHOE	NYSE	205.77	7.00	4.58	6.60	79.32
MOTOROLA	NYSE	1311.77	41.13	37.34	47.00	1001.46
MUNSINGWEAR	NYSE	98.39	2.40	2.18	4.39	58.08
MURPHY OIL	NYSE	931.03	40.14	87.79	3.97	1165.28
NATL SEMICN	NYSE	235.46	16.75	12.62	15.31	135.37
NATL STD CO	NYSE	226.32	9.41	9.53	4.53	144.67
NEPTUN INTL	NYSE	117.78	5.00	4.85	2.36	81.97
NOEST UTIL	NYSE	721.79	93.47	-2.18	7.45	2741.95
NOR AM MTG	NYSE	29.34	8.06	0.00	0.01	215.68
NORFOLK&WST	NYSE	1050.92	87.51	40.61	28.29	2565.90
NOWST BANCP	NYSE	540.28	58.30	20.57	0.00	7386.97
NVF CORP	NYSE	533.35	44.07	43.20	1.85	352.54
OKLA NAT GS	NYSE	255.05	19.94	17.58	2.25	375.03
OLIN CORP	NYSE	1260.59	59.41	44.80	23.71	1013.59
OLINKRAFT	NYSE	284.89	24.35	16.47	0.00	287.31
OTIS ELEVTR	NYSE	1104.17	43.53	50.17	50.70	764.21
PANHNDL EAS	NYSE	659.28	72.34	44.74	0.00	1694.57
PAYLESS N W	NYSE	172.89	4.62	3.86	2.59	52.66
PEABODY GAL	NYSE	302.72	10.70	7.01	7.18	218.46
PENNEY J C	NYSE	7678.60	189.60	161.60	186.00	3226.00
PHILA SUBURBAN CORP.	NYSE	161.15	11.76	10.36	3.14	217.78
PITTSTON CO	NYSE	1145.73	113.64	79.73	17.13	687.66
POLAROID CP	NYSE	812.70	62.59	60.68	13.39	834.31

CLIENTS OF PEAT, MARWICK, MITCHELL & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
POTLATCH CP	NYSE	504.29	37.47	14.36	10.24	473.65
PREMR INDL	NYSE	165.14	11.68	10.83	2.30	89.80
PS CO N H	NYSE	186.39	20.81	8.44	1.53	483.74
PS CO N M	NYSE	84.98	14.22	8.20	1.33	370.51
PUEBLO INTL	NYSE	589.43	1.94	2.87	9.50	121.71
PUROLATOR	NYSE	292.95	14.18	14.55	13.36	147.35
QUESTOR CP	NYSE	406.53	2.25	2.90	11.00	293.27
READING CO.	NYSE	156.38	-1.14	16.09	5.94	310.36
REICHLD CHM	NYSE	407.86	15.95	13.09	4.31	237.10
REVCO D S	NYSE	461.17	10.56	10.60	9.00	158.40
REVLON INC	NYSE	753.18	62.62	55.55	19.50	752.44
RIVIANA FDS	NYSE	463.69	11.85	8.61	8.50	223.26
ROCKOWER	NYSE	90.53	4.45	4.84	1.50	37.78
ROHM & HAAS	NYSE	1046.05	22.98	-0.94	19.19	1092.04
RUBBERMAID	NYSE	154.00	10.22	9.60	3.26	112.21
RYDER SYSTM	NYSE	577.25	11.88	7.75	11.66	667.75
SAFEWAY STR	NYSE	9716.89	148.63	126.50	126.96	1574.67
SAV-A-STOP	NYSE	201.91	-1.11	-0.89	3.80	69.73
SIMMONDS PR	NYSE	52.10	2.31	1.92	0.00	33.50
SINGER CO	NYSE	2587.00	29.00	1.00	111.00	2016.10
SMITHKLINE	NYSE	588.73	63.59	30.62	13.72	580.13
SO UNION GS	NYSE	165.91	16.20	6.97	2.38	335.90

SOUTHEASTN PUB SERV CO	NYSE	72.59	2.54	2.25	3.06	65.48
SQUIBB CORP	NYSE	1111.03	98.17	43.28	34.00	1169.02
STD PRUDENTIAL CORP.	NYSE	39.11	2.12	-1.45	2.59	507.54
STD BRD PNT	NYSE	115.77	8.87	9.49	2.29	62.22
STD PRESSED	NYSE	159.99	2.20	5.01	5.06	130.52
STOP & SHOP	NYSE	1223.79	10.11	7.21	23.00	261.99
SWSTN PUB S	NYSE	168.22	27.29	13.93	1.92	558.10
SYSTRON-DON	NYSE	57.59	1.42	1.26	1.91	38.89
TAFT BRDCST	NYSE	89.95	11.65	10.18	1.00	178.60
TEXASGULF	NYSE	444.64	103.22	68.25	4.87	1155.74
THOMASBETT	NYSE	111.00	13.26	11.11	2.13	98.72
TIDEWTR MAR	NYSE	101.58	18.37	7.94	2.82	174.98
TRE CORP	NYSE	69.30	-7.53	-1.19	2.30	95.42
TWEN CENTRY	NYSE	340.59	17.38	14.81	0.00	322.99
TX GS TRANS	NYSE	1312.03	114.02	81.19	5.00	2725.65
UNION BANC	NYSE	256.05	12.27	-2.40	0.00	4025.01
UNION FIDELITY CORP.	NYSE	35.82	2.43	0.44	0.30	81.20
UNIONAMERICA, INC.	NYSE	87.61	-18.23	-4.31	1.40	366.81
USLIFE CP	NYSE	429.34	48.91	16.83	0.00	1837.25
UTD JERSEY	NYSE	129.94	8.09	-1.31	2.48	1845.64
UTD NUCLEAR	NYSE	77.82	0.42	0.03	3.30	135.20
VORNADO INC	NYSE	893.03	2.45	1.09	18.00	376.30
WACHOVIA RL	NYSE	14.83	-10.21	0.00	0.00	143.23
WAYNE-GOSSRD	NYSE	49.74	1.01	1.01	0.00	33.14
WEBB DEL	NYSE	304.46	4.19	3.75	8.80	239.66
WELLS FARGO	NYSE	937.91	56.15	24.66	12.14	2362.20
WESCO FIN	NYSE	35.44	4.35	3.08	0.00	470.13

CLIENTS OF PEAT, MARWICK, MITCHELL & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
WESTN AIRL	NYSE	488.40	24.10	17.73	9.42	396.82
WINN-DIXIE	NYSE	2962.16	55.55	51.51	39.17	445.51
WOODS CORP	NYSE	100.46	5.01	0.79	2.00	83.73
XEROX CORP	NYSE	4053.76	341.63	342.60	93.53	4455.64
AAV COS	AMSE	95.55	1.75	1.63	1.00	35.27
ABERD M & C	AMSE	22.69	3.44	1.41	0.00	62.64
ALLEG AIRL	AMSE	368.55	4.56	1.52	0.00	290.45
AM MTR INNS	AMSE	72.61	-0.55	-0.39	4.00	127.86
AM PETROFIN	AMSE	986.04	40.19	11.57	3.06	601.61
APPLD DATA	AMSE	11.89	0.19	0.21	0.30	7.69
AVEMCO CORP.	AMSE	13.01	1.37	0.28	0.11	37.71
AVONDL MILL*	AMSE	173.73	3.99	2.71	5.98	109.90
BARRY R G	AMSE	52.26	1.68	1.62	0.00	27.65
BARTH SPNCR	AMSE	17.33	0.40	0.35	0.25	5.62
BARUCH-FSTR	AMSE	1.91	0.36	0.35	0.00	2.95
BINKS MFG	AMSE	53.48	3.50	3.63	1.04	44.08
BOHACK CORP. (THE)	AMSE	281.61	-69.24	-1.76	2.06	53.84
BREWER (C)	AMSE	293.25	7.25	5.02	7.00	287.78
BFC-MART	AMSE	38.46	0.59	0.55	1.04	21.22
BUELL INDS	AMSE	35.04	1.63	1.43	0.82	26.20
CDI CORP	AMSE	82.07	0.64	0.81	0.00	20.84
CDN EXP OIL	AMSE	6.12	1.79	0.90	0.03	19.93

CEN HOMESTD	AMSE	4.44	1.31	0.67	0.00	28.31
CINERAMA	AMSE	72.70	-2.99	0.00	2.80	77.41
CIRCLE K	AMSE	228.33	4.72	4.33	4.48	63.44
CMI CORP	AMSE	71.05	1.04	0.32	1.12	57.99
COLONIAL COM CORP.	AMSE	12.74	-0.96	0.01	0.46	53.86
COLWELL CO.	AMSE	12.83	-1.38	-1.25	0.38	121.07
CMNTY P S	AMSE	74.09	4.04	2.62	0.72	121.02
COMPTR INVS*	AMSE	28.68	-4.54	-1.15	0.19	83.55
CONS REFIN	AMSE	36.76	0.95	1.06	0.00	12.69
COOPER-JAR	AMSE	50.52	-0.71	-0.59	1.59	25.74
CRAIG CORP	AMSE	69.11	3.29	3.60	0.57	33.43
DATA DOCUM	AMSE	64.75	2.86	2.27	0.90	28.15
DEL LABS	AMSE	27.38	1.72	1.65	0.56	26.42
DESIGNCRAFT	AMSE	13.87	-2.05	-1.85	0.00	21.88
DISCNT FAB	AMSE	15.70	0.26	0.33	0.69	8.39
DOWNEY S & L ASSOC.	AMSE	36.00	3.49	1.92	0.30	482.12
EDO CORP	AMSE	53.89	1.12	0.54	1.67	38.26
ESPEY MFG	AMSE	5.63	0.06	0.06	0.26	5.35
FED-MART	AMSE	361.71	3.76	3.39	5.40	93.04
FLAGSTAF CP	AMSE	103.10	1.78	1.82	0.73	37.80
GATEWAY SPORTG GDS CO.	AMSE	16.55	-1.60	0.03	0.79	13.41
GEN EDUCATN	AMSE	38.25	4.01	0.82	1.57	25.57
GERBER SCIEN	AMSE	13.58	-0.17	-0.20	0.33	15.94
GRT SCOTT	AMSE	383.16	0.79	0.02	4.70	51.19
HALLS MOTOR	AMSE	308.15	2.49	2.16	0.00	65.26
HASBRO INDS	AMSE	95.44	2.02	1.46	2.34	54.98
HIPOTRONICS	AMSE	6.02	0.90	0.68	0.13	7.42

CLIENTS OF PEAT, MARWICK, MITCHELL & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
HUFFMN INDS	AMSE	43.51	0.67	1.02	0.75	30.36
HUDSN BAY-C	AMSE	183.20	58.35	44.38	1.24	487.35
HUFFMAN MFG	AMSE	93.09	1.11	0.86	1.63	51.92
HUSKY OIL	AMSE	435.31	33.68	18.89	2.61	393.47
HYGRAD FOOD	AMSE	338.57	5.29	4.39	3.50	73.26
INTL FUNERL	AMSE	34.44	1.58	1.92	1.23	53.77
INVT CP-FLA	AMSE	11.01	0.04	-0.19	0.30	44.66
IST INDUSTRIES, INC.	AMSE	99.60	1.33	-0.56	1.92	458.01
ITEL CORP	AMSE	204.00	10.70	8.40	0.00	344.90
KANEB SERV	AMSE	98.49	11.92	5.31	1.68	127.68
KNOTT HOTEL	AMSE	30.04	-5.67	0.49	2.20	10.10
LANDMK LAND*	AMSE	8.81	-0.71	0.00	0.00	21.73
LEWIS BUS	AMSE	32.01	1.77	1.39	0.62	20.97
LINCOLN AM	AMSE	37.89	1.68	1.12	0.00	123.52
LUNDY ELEC	AMSE	20.52	0.14	0.11	0.78	22.33
MAT RESEARC	AMSE	14.49	0.25	0.18	0.22	9.15
MCKEON CONS	AMSE	43.41	-5.83	-5.43	0.18	151.78
MEDENCO INC	AMSE	61.00	2.35	1.27	0.00	52.25
MOOG INC	AMSE	62.45	2.12	1.28	1.81	43.19
MORTN SHOE	AMSE	82.42	0.90	0.72	2.24	40.14
MPO VIDEO	AMSE	13.51	-0.37	0.33	0.21	9.26
MTG GROWTH	AMSE	3.77	-0.27	0.00	0.00	42.78

NEISNER BRO	AMSE	150.65	-0.51	-0.51	5.40	48.07
N CNEX INTL	AMSE	235.17	3.47	3.50	3.37	104.14
NIAG FRONTS	AMSE	221.43	5.20	4.80	3.77	43.59
NC CON OIL	AMSE	9.00	3.28	1.78	0.00	38.87
OEA INC	AMSE	12.02	0.85	0.86	0.50	11.92
PLANTRON INC	AMSE	27.07	2.96	2.79	0.79	19.32
RACON INC	AMSE	21.02	1.63	1.75	0.00	14.49
RAYMND PREC	AMSE	18.58	0.58	0.61	0.00	11.52
REEVES TEL	AMSE	6.93	-0.63	-0.07	0.20	17.74
REFRIG TRAN	AMSE	65.27	-3.76	-2.33	0.00	26.93
REP NY CORP	AMSE	95.39	13.53	5.45	0.00	1141.46
ROBINTECH	AMSE	92.51	11.99	8.57	1.60	83.66
ROCKAWAY CP	AMSE	22.12	1.24	1.22	0.66	15.78
ROCKWD COMPUTER CORP*	AMSE	0.00	0.00	0.00	0.00	0.00
ROLAND INTL	AMSE	8.54	0.50	0.51	0.14	50.04
SAFETRN SYS	AMSE	20.76	1.53	1.70	0.54	17.70
SAN JOSE WATER WORKS	AMSE	21.32	3.12	2.11	0.24	91.23
SCABRD ALLD	AMSE	320.51	1.60	1.45	0.97	100.51
SECURITY PLASTICS INC.	AMSE	7.41	-0.10	-0.11	0.24	6.25
SERVISCO	AMSE	63.87	1.04	0.51	6.40	38.66
SPECTOR IND	AMSE	177.74	-3.15	-1.40	6.05	94.08
STERLG EXTR	AMSE	10.66	0.20	0.16	0.18	9.10
STERLNG ELE*	AMSE	62.00	1.23	1.34	1.02	22.76
TEXSTAR CP	AMSE	120.75	1.57	1.27	2.60	63.24
THOROFARE	AMSE	191.55	-2.59	-0.25	2.05	22.91
U S RADIUM	AMSE	10.08	-0.13	-0.25	0.28	10.40
U S RUBBER	AMSE	5.85	0.49	0.41	0.00	6.22

MARWICK, MITCHELL & CO. (CONTINUED)

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
UNITY BUY S	AMSE	59.53	2.46	2.19	0.80	24.92
UNIVERSITY SAV ASSN.	AMSE	13.45	0.92	0.34	0.10	183.16
VAN DORN CO	AMSE	106.26	3.49	3.11	2.06	66.38
VARO INC	AMSE	49.22	3.91	3.28	1.45	28.77
VIATECH	AMSE	6.53	-0.12	-0.11	0.28	5.89
VOPLEX CORP	AMSE	11.05	0.36	0.35	0.40	10.34
WARDS CO	AMSE	68.68	-2.99	-1.10	0.74	18.37
WILSON BROS	AMSE	42.73	1.31	1.33	2.72	36.55
WMHOUSE REG	AMSE	64.57	3.80	3.84	1.91	45.95

CLIENTS OF ARTHUR YOUNG COMPANY

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
AKZONA	NYSE	631.72	7.87	1.34	15.79	656.18
ALABAMA GAS	NYSE	95.60	4.55	4.09	1.01	106.23
ALISON MTG	NYSE	17.27	-58.17	0.00	0.00	199.03
ALRGHT AUTO	NYSE	43.33	1.90	1.59	1.73	37.02
AM AIRLINES	NYSE	1641.31	20.45	6.80	35.82	1640.69
AM DISTIL	NYSE	42.30	-5.48	-3.65	0.85	62.95
AM STD INC	NYSE	1622.26	44.76	52.12	48.30	1018.66
AMERADA HES	NYSE	3179.57	128.40	196.07	6.15	2385.46
AMF INC	NYSE	1004.70	32.13	30.00	28.30	779.47
AMTEL INC	NYSE	349.42	5.56	5.06	0.00	173.99
ARCATA NATL	NYSE	265.27	11.56	4.40	9.00	206.03
AEC CORP	NYSE	46.33	5.15	2.84	1.48	44.47
ASSOCIATED SPRING CORP.	NYSE	206.70	7.64	8.54	6.26	122.31
AUTOMTN INC	NYSE	240.37	4.83	4.65	9.05	127.87
AVCO CORP	NYSE	608.43	32.14	12.62	23.00	1250.40
BALLY MFG	NYSE	166.08	7.50	9.20	4.30	144.14
CABOT [illegible]	NYSE	18.67	-20.26	0.00	0.00	206.17
CAP CITIES	NYSE	174.89	25.40	26.60	2.90	315.13
CENTL SOYA	NYSE	1789.29	18.20	15.40	9.35	408.21
CESSNA AIRC	NYSE	491.58	16.47	14.27	13.50	320.38
CHESEBROUGH	NYSE	674.58	47.92	41.62	15.43	478.58
COLLINS AIR	NYSE	337.70	7.28	5.60	8.00	213.39

CONRAC CORP	NYSE	90.43	3.50	3.79	2.77	63.33
CONT OIL CO	NYSE	7253.80	330.85	660.70	44.03	5184.58
COOPER TIRE	NYSE	165.25	4.39	2.96	3.63	101.21
DENNYS INC	NYSE	283.38	11.10	10.85	25.30	140.36
DPF INC*	NYSE	22.54	0.38	0.26	0.10	54.10
ELCTRN DATA	NYSE	119.38	14.65	12.40	3.66	96.75
ELCTRN MEMR	NYSE	92.20	-2.24	1.25	3.65	56.77
EMPIRE DIST	NYSE	39.75	3.93	2.83	0.51	104.63
EQUITABL GS	NYSE	136.41	13.52	6.76	2.26	281.50
ESMARK INC	NYSE	4730.73	79.69	65.80	33.60	1473.92
FEDDERS CP	NYSE	170.23	-13.43	-13.43	5.10	241.66
FINL FEDERT	NYSE	107.36	9.41	4.90	0.50	1461.44
FLDCRST MIL	NYSE	303.34	9.93	9.54	0.00	199.47
FLA EAST COAST RWY CO.	NYSE	49.59	6.15	4.28	1.20	118.11
FLUOR CORP	NYSE	1325.42	47.41	52.43	16.58	538.45
GAS SERVICE CO, THE	NYSE	137.76	6.84	4.02	2.66	221.48
GCA CORP	NYSE	39.98	0.39	0.24	0.98	35.41
GEN CABLE*	NYSE	326.63	21.66	11.06	5.20	341.48
GEN INSTR	NYSE	419.66	11.78	9.15	22.30	386.45
GIDDINGS &L	NYSE	122.22	5.07	5.20	3.41	90.93
HANDLEMN CO	NYSE	104.64	3.85	4.26	0.88	54.10
HESSTON CP	NYSE	207.86	8.28	6.71	4.22	161.64
HEUBLEIN	NYSE	1123.44	61.50	62.11	25.91	742.92
HOUGHT MIFF	NYSE	97.12	6.92	6.58	1.52	86.85
IMPERL CORP	NYSE	257.55	28.98	13.48	0.00	3678.71
INA CORP	NYSE	2246.52	79.61	-19.20	22.00	3859.36
INTL MINRLS	NYSE	1302.90	161.80	113.00	10.46	1037.50

CLIENTS OF ARTHUR YOUNG COMPANY--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
INTERST BRND	NYSE	422.04	6.34	4.35	11.35	110.74
ION PHOEM	NYSE	108.37	-7.67	0.37	3.80	116.64
KOPPERS CO	NYSE	1075.46	60.33	40.64	17.55	679.71
LOCKHEED AI	NYSE	3279.10	23.20	11.70	62.10	1634.10
LUDLOW CORP	NYSE	131.24	-1.18	-1.10	9.40	122.82
MADISON SQG	NYSE	158.54	3.60	2.81	0.00	284.39
MARATHN MFG	NYSE	293.66	14.99	13.37	9.16	212.97
MARXL CORP	NYSE	708.77	5.72	4.10	2.75	99.38
MCDONNL CP	NYSE	926.37	86.88	85.04	0.00	1069.41
MCGRAW-HILL	NYSE	536.47	33.12	33.45	11.90	453.72
M-NASCO MFG	NYSE	80.92	4.72	4.16	1.92	69.05
MGIC INVEST	NYSE	150.62	26.43	10.56	1.05	792.09
MI[illegible], INC.	NYSE	293.81	10.96	9.77	6.10	131.03
MOBIL OIL	NYSE	6620.41	809.88	2363.15	0.00	5050.30
MONT-DAK UT	NYSE	86.54	11.38	6.70	0.00	285.18
NORTON CO	NYSE	548.33	20.89	15.59	18.56	447.89
OKC CORP	NYSE	105.42	7.15	6.37	0.35	112.36
OVERNIT TRN	NYSE	95.03	6.15	5.79	3.89	70.21
OWENS-ILL	NYSE	2273.17	87.34	51.00	0.00	1947.87
PAINE W.[illegible]	NYSE	188.42	11.80	11.92	4.70	525.85
PEPSICO INC	NYSE	2321.24	104.60	81.71	49.05	1363.92
PETROLANE	NYSE	566.42	27.37	25.89	6.98	284.68

PHILLIP PET	NYSE	5133.55	342.57	409.45	30.51	4544.92
PIONEER CP	NYSE	231.03	19.32	11.98	2.19	276.59
POPE&TALBOT	NYSE	72.99	3.99	3.55	0.00	80.77
PULLMAN INC	NYSE	2006.98	39.35	14.71	26.30	886.45
RCA CORP	NYSE	4789.50	110.00	78.60	113.00	3728.40
RICHMOND CP	NYSE	328.17	26.68	9.58	0.00	1301.57
SCA SERVICE	NYSE	149.03	-3.19	-1.89	6.90	173.15
SEABRD WELF	NYSE	122.06	2.56	0.52	1.81	123.06
SERVICE CP	NYSE	75.09	4.85	4.97	2.82	113.64
SHELLER-GLB	NYSE	430.41	14.79	12.49	12.66	241.42
SMITH A O	NYSE	451.81	4.07	-2.20	10.40	313.09
SO NAT RESC	NYSE	626.39	69.30	46.19	0.00	1189.62
SONESTA INT	NYSE	94.29	4.08	2.08	0.00	61.36
SPARTON CP	NYSE	60.66	3.60	3.21	2.20	35.17
SPERRY RAND	NYSE	3040.86	131.42	111.80	92.96	2533.12
STERLG PREC	NYSE	115.80	4.11	3.64	2.51	80.87
SUB PROPANE	NYSE	275.83	11.35	10.39	3.70	190.75
TELEPROMPTR	NYSE	86.81	-7.34	0.00	3.50	297.74
TEXAS INSTR	NYSE	1367.62	62.14	53.80	56.68	941.48
THIOKOL CP	NYSE	345.07	14.34	12.78	8.17	208.50
TODD SHIPYD	NYSE	216.64	-43.36	-1.00	8.50	121.23
TRANSOHIO FIN CORP.	NYSE	68.54	5.45	1.32	0.47	1072.74
TRINITY IND	NYSE	217.19	8.06	7.44	4.40	114.22
TYLER CORP	NYSE	293.64	14.98	12.50	6.30	170.81
UMC INDS	NYSE	192.04	5.81	5.78	0.00	123.49
UNIV LEAF	NYSE	760.47	13.99	14.19	12.50	237.20
UTD TELECOM	NYSE	944.76	91.08	80.39	27.55	2551.70

CLIENTS OF ARTHUR YOUNG COMPANY--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
VEEDER INDS	NYSE	82.80	4.10	4.73	3.25	66.14
WAL-MART	NYSE	236.21	6.35	5.86	5.80	75.22
WEST PT PEP	NYSE	526.00	19.76	16.00	22.00	360.02
WILLIAM COS	NYSE	881.90	117.18	60.88	0.00	1519.89
WRIGLEY WM	NYSE	271.72	18.16	15.67	5.18	194.53
WYLY CORP	NYSE	63.05	-20.55	2.28	0.00	143.95
ALAN WOOD	AMSE	143.87	-9.41	-7.80	2.94	125.58
ARROW ELECT	AMSE	92.83	2.29	2.04	0.95	47.24
AVONDL MILL*	AMSE	173.73	3.99	2.71	5.98	109.90
BADGER METR	AMSE	42.76	1.02	0.83	1.20	31.38
BANISTR LTD	AMSE	25.61	-1.38	-0.29	0.62	55.13
BASIN PETROLEUM CORP.	AMSE	23.13	3.79	1.30	0.40	34.51
BERTEA CORP	AMSE	35.37	1.62	1.21	1.08	28.95
BEVERLY ENT	AMSE	85.85	1.43	1.72	7.20	71.11
BLUEBIRD INC	AMSE	341.51	3.57	3.54	1.83	68.40
BURGESS IND	AMSE	42.22	1.17	0.94	0.80	19.45
CERTIFD CP	AMSE	25.25	-0.80	0.60	0.64	12.70
COFFEE MAT	AMSE	9.47	0.99	0.81	0.23	9.01
COHU INC	AMSE	15.39	0.35	0.29	0.42	9.41
COMM GROUP	AMSE	6.05	0.83	0.72	0.03	35.02
COMPTR INVS*	AMSE	28.68	-4.54	-1.13	0.19	83.55
CONRAC CORP	AMSE	217.85	4.50	3.66	5.30	170.29

CORENCO CP	AMSE	35.03	0.58	0.02	0.52	25.07
COSCO INC	AMSE	56.96	-2.06	-0.48	0.00	36.22
CRUTCHER RES	AMSE	64.32	5.86	4.35	1.65	61.91
DATAPROD CP	AMSE	94.69	5.82	3.79	3.00	75.43
EASON OIL	AMSE	24.91	3.56	1.79	0.13	43.17
EDDINGTN OIL	AMSE	127.50	10.54	7.72	0.28	59.67
ELCTRN ENG	AMSE	17.72	1.30	1.21	0.00	11.73
ERNST (E C)	AMSE	96.04	2.15	2.33	3.00	28.33
FANNY FARMS	AMSE	28.71	0.18	0.15	1.85	11.01
FDI INC	AMSE	71.62	-9.69	-3.58	0.90	62.77
FIRSTMARK CORP.	AMSE	53.11	1.90	0.88	0.57	325.40
FISCHER & PR	AMSE	0.00	0.00	0.00	0.00	0.00
FLA ROCK	AMSE	83.73	0.45	-0.04	1.50	60.90
GENGE INC	AMSE	32.54	0.61	0.53	1.20	16.48
GENISCO TECH CORP.	AMSE	10.81	0.35	0.35	0.45	5.36
GRI CORP	AMSE	60.19	1.69	1.32	0.50	26.18
HOMDALE ENTERPRISES	AMSE	4.27	1.53	0.05	0.05	8.98
HUNTING HRA	AMSE	23.37	0.88	0.83	1.22	17.39
HYCEL INC	AMSE	25.14	1.02	1.37	0.00	27.27
INDIAN HEAD, INC.	AMSE	413.41	4.32	19.00	9.50	325.54
INSTRON CP	AMSE	25.38	0.22	0.87	0.68	22.62
INTL SYSTEM	AMSE	318.44	6.64	6.98	3.63	175.13
KAY CORP	AMSE	232.85	2.94	2.95	1.59	101.69
LEE NATIONAL CORP.	AMSE	19.77	-4.19	0.03	0.13	182.52
LODGE &SHIP	AMSE	25.75	1.52	1.44	0.52	17.90
LSB IND	AMSE	27.81	0.85	0.76	0.70	25.67
MANSFLD TIR	AMSE	106.62	0.10	-0.66	0.00	75.68

CLIENTS OF ARTHUR YOUNG COMPANY--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
MARSHAL FDS	AMSE	38.37	-0.46	-0.41	0.38	14.77
MCCULLOCH	AMSE	124.31	3.05	0.48	0.00	362.89
MEDIA GEN	AMSE	144.95	8.89	8.57	3.48	159.82
MEM CO	AMSE	35.41	2.78	2.73	0.82	26.14
MERCHANTILE INDUS, INC	AMSE	30.86	-2.49	-1.98	0.23	147.46
MIDLND GLAS	AMSE	110.43	4.21	4.13	2.20	50.33
MOULDING INC	AMSE	1.67	-1.12	-0.68	0.08	4.25
NATL HEALTH	AMSE	61.28	-0.82	-0.50	7.00	56.38
NATL KINNEY	AMSE	402.61	2.32	2.21	20.00	666.65
NEWPARK RES	AMSE	28.86	1.28	0.97	1.10	20.27
OFFSHORE CO	AMSE	172.22	28.66	6.95	3.50	357.21
PALOMAR FINANCIAL	AMSE	6.95	-0.04	-0.08	0.25	50.44
PEP BOYS	AMSE	83.96	3.52	3.52	1.75	50.43
PREL CORP.	AMSE	47.92	-14.47	-6.56	0.28	97.28
PS CO COLO	AMSE	463.63	57.10	19.07	5.95	1378.62
PSA INC	AMSE	154.81	1.59	0.23	3.48	203.20
PULTE HOMES	AMSE	55.76	0.09	0.00	0.27	60.49
REP HOUSING	AMSE	14.10	-1.94	-0.48	0.33	12.59
RESERVE OIL	AMSE	0.00	17.02	14.32	1.23	307.23
SEALECTRO	AMSE	18.72	0.73	0.68	1.00	15.19
STANLEY AV	AMSE	4.65	0.39	0.32	0.14	4.83
SW AIRLINES	AMSE	22.79	2.16	1.51	0.00	23.69

TEXTRON INC	AMSE	2459.06	95.96	72.35	64.00	1433.33
TIMPTE INDS	AMSE	44.04	-0.27	-0.31	0.55	19.17
TREADWY COS	AMSE	17.50	0.24	0.08	1.10	15.47
U S FILTER	AMSE	208.98	9.16	2.31	4.50	212.68
UNITEK CORP	AMSE	31.58	1.95	1.96	1.23	22.50
VIKOA INC	AMSE	10.03	-3.48	0.12	0.21	28.33
WARNER COMM	AMSE	669.77	50.12	18.27	0.00	804.21
WATSCO INC	AMSE	5.86	0.05	0.01	0.16	5.11
WESTN PAC	AMSE	185.73	3.69	5.87	0.00	295.74
WOLF HOWARD	AMSE	9.29	-0.17	-0.03	0.45	6.66
WYNNS INTL	AMSE	62.89	4.96	4.25	1.20	45.45
XONICS INC	AMSE	15.81	0.53	0.78	0.33	14.07

CLIENTS OF ERNST & ERNST

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
ACME-CLEVLD	NYSE	231.49	6.96	5.82	6.49	178.14
ADAMS-MILLIS	NYSE	63.01	0.57	0.56	2.87	35.39
ALCO STD	NYSE	931.95	31.16	23.30	12.00	423.56
AM GEN INS	NYSE	1361.43	46.64	-1.37	0.00	4083.35
AMFFACE CP	NYSE	196.86	8.07	6.93	6.50	182.58
AMERICAN FIN SYS, INC.	NYSE	120.35	2.40	-0.59	2.69	509.40
APECO CORP	NYSE	118.45	0.35	-0.78	3.00	71.50
ARCHER-DAN	NYSE	1822.88	34.95	33.04	3.94	482.83
ARK BEST CP	NYSE	113.25	-3.86	1.97	3.67	66.99
ARMSTRNG RP	NYSE	287.41	4.49	1.68	5.32	254.36
ASHLND OIL	NYSE	3637.12	119.37	124.07	27.00	1973.02
BANDAG INC	NYSE	168.87	19.00	18.25	2.01	111.35
BANK OF VA	NYSE	160.23	11.39	1.51	3.33	1601.20
BASIC INC	NYSE	53.50	2.57	0.40	0.00	48.62
BECTON DICK	NYSE	456.04	33.76	26.23	15.30	450.54
BEECH AIRCR	NYSE	267.15	15.61	13.78	7.75	180.49
BIG THREE	NYSE	211.47	27.82	16.99	0.00	291.92
BLACK DECKR	NYSE	653.90	35.41	33.25	17.20	643.66
BROWN CO	NYSE	400.31	16.70	10.24	8.65	288.95
BROWN GROUP	NYSE	752.15	13.12	13.30	0.00	363.19
BRUSH WELMN	NYSE	74.96	3.77	3.25	1.70	101.80
BUFFALO FRG	NYSE	82.60	4.04	3.99	2.40	50.75

CAP HLDG CP	NYSE	352.21	48.84	19.79	0.00	1633.54
CINN MILCRN	NYSE	450.19	9.95	6.97	13.37	375.37
CLARK OIL	NYSE	600.41	5.24	-3.50	5.05	308.82
CLEV-CLIFFS	NYSE	170.43	31.00	12.41	0.00	284.29
COCA-CL BTL	NYSE	258.18	6.46	7.81	3.50	181.33
COCA-CL CO	NYSE	2872.84	239.31	220.91	0.00	1710.87
COLDWEL BAN	NYSE	76.49	1.60	1.47	3.06	66.66
CONT ILL	NYSE	1441.24	119.00	76.16	9.93	0225.30
COPELAND CP	NYSE	159.48	6.31	5.35	2.77	38.78
COWLES COMM	NYSE	10.31	2.75	0.76	0.00	45.35
CRANE CO	NYSE	1119.49	63.61	50.59	25.00	722.20
DAYCO CORP	NYSE	401.48	8.79	7.19	10.72	271.13
DAYTN HUDS	NYSE	1504.47	25.18	24.89	45.00	856.47
DENNISN MFG	NYSE	245.35	9.61	9.31	7.00	156.54
E-SYSTEMS	NYSE	254.20	7.16	5.19	9.07	95.37
EATON CORP	NYSE	1558.29	47.04	50.37	43.35	1254.08
FED-MOGUL	NYSE	367.01	10.70	7.90	13.57	292.69
FISHER FOOD	NYSE	1379.99	12.43	9.11	0.00	278.12
FLA STEEL	NYSE	131.97	7.41	6.77	1.90	76.52
FST VA BANK	NYSE	80.06	6.77	2.41	2.49	1075.34
FUQUA INDS	NYSE	550.72	9.56	9.24	16.28	440.93
GABLE INDS	NYSE	151.56	3.39	3.63	1.60	94.93
GATEWY INDS	NYSE	55.33	-0.69	-0.48	0.90	23.31
GEN AM OIL	NYSE	88.53	23.31	18.16	0.93	296.08
GEN AM TRANS	NYSE	567.63	44.74	27.62	0.00	1282.68
GEN MEDICAL	NYSE	145.63	3.54	3.60	1.40	64.44
GENUIN PART	NYSE	572.83	24.01	25.41	8.50	204.32

CLIENTS OF ERNST AND ERNST--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
GERBER PRDS	NYSE	328.14	16.34	16.07	7.71	186.58
GF BUS EQPT	NYSE	94.63	0.71	0.29	0.00	65.41
GIANT PORT	NYSE	17.56	1.94	1.62	0.00	34.52
GIBRALTAR	NYSE	136.93	10.14	6.40	0.76	1821.62
GIFFORD-HIL	NYSE	209.96	6.20	3.12	5.17	181.92
GLEASON WRK	NYSE	83.53	2.05	1.08	2.87	84.61
GOODRICH BF	NYSE	1901.20	25.56	14.12	44.90	1596.82
GOULD INC	NYSE	772.87	37.06	22.92	20.70	641.66
GRAY DRUG	NYSE	272.06	3.92	3.58	5.70	100.18
GULF &WSTRN	NYSE	2602.15	140.06	46.00	100.00	3305.70
HANES CORP	NYSE	314.79	10.62	5.30	12.75	170.27
HANNA MIN	NYSE	331.64	47.35	19.22	0.00	384.97
HARRIS CORP	NYSE	479.06	19.46	10.16	13.20	370.10
HARTE-HANKS	NYSE	77.70	6.52	6.75	3.34	88.32
HOOVER BALL	NYSE	270.50	11.72	12.20	6.31	148.69
HOSP CORP	NYSE	356.30	20.95	16.10	0.00	506.21
JOSTENS INC	NYSE	151.01	8.24	8.57	4.30	90.43
KELLER INDS	NYSE	111.64	1.14	1.32	3.60	71.50
KNIGHT-RIDR	NYSE	593.32	31.49	32.00	13.86	480.51
LAWSON &SNS	NYSE	89.58	3.14	2.39	1.89	75.11
LEESONA CP	NYSE	99.66	4.77	1.40	3.37	88.21
LIBBEY OWEN	NYSE	684.10	31.90	19.00	18.31	573.06

LILLY ELI	NYSE	1233.74	181.27	117.36	23.50	1433.90
LINCOLN NATIONAL CORP.	NYSE	1265.12	76.11	28.95	12.46	4298.59
LOMAS NETTN	NYSE	43.82	7.47	0.00	0.00	339.64
LTV CORP	NYSE	4312.46	13.14	-19.47	60.40	1962.81
MALONE&HYDE	NYSE	887.18	12.20	10.46	4.70	124.62
MANPOWER, INC.	NYSE	161.19	2.89	4.31	1.40	50.69
MARATHN OIL	NYSE	2878.17	128.12	338.71	11.87	2005.42
MARTIN MRTA	NYSE	1053.37	55.37	24.40	21.70	1139.04
MAYTAG CO	NYSE	237.58	25.94	22.68	3.64	134.06
MCCORD CORP	NYSE	136.40	3.56	3.30	3.90	68.18
MCDONNEL DC	NYSE	3255.67	85.65	40.13	62.83	2207.74
MCKEE ARTHR	NYSE	650.87	6.50	7.20	5.03	118.03
MCLEAN TRCK	NYSE	320.37	9.99	7.43	9.30	150.78
MCLOUTH STL	NYSE	365.83	5.73	0.60	4.80	328.89
MEDUSA CORP	NYSE	174.82	4.55	2.28	2.79	171.74
MIDLND-ROSS	NYSE	410.09	21.83	18.18	8.20	351.04
MO PORTLAND	NYSE	55.64	5.62	-0.60	1.07	96.94
MORTN NORCH	NYSE	538.42	17.54	15.44	12.30	459.94
MT FUEL SUP	NYSE	138.56	17.08	2.76	1.90	306.19
MTG TR AMER	NYSE	12.72	-15.14	0.00	0.00	148.03
MURRAY OHIO	NYSE	126.66	4.73	4.54	2.21	77.70
NALCO CHEM	NYSE	313.93	32.07	24.37	3.52	215.75
NATL GYPSUM	NYSE	534.46	22.23	10.70	12.54	485.10
NATL STEEL	NYSE	2241.17	58.04	5.50	33.35	2410.48
NLT CORP	NYSE	498.08	88.53	35.64	0.00	2816.31
NO AM COAL	NYSE	245.83	7.83	3.00	6.50	258.06
NOWST AIRL	NYSE	758.99	64.75	33.63	11.52	1121.15

CLIENTS OF ERNST AND ERNST--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
OUTLET CO	NYSE	99.67	4.08	4.13	3.60	77.59
PETER PAUL	NYSE	87.25	3.37	3.15	1.13	33.02
PITTS FRG	NYSE	141.08	2.71	2.48	2.35	77.75
PIZZA HUT	NYSE	167.52	10.02	9.40	11.53	85.19
PONDEROSA S	NYSE	129.73	2.22	1.37	12.98	69.40
REDMAN INDS	NYSE	173.25	-0.47	-0.23	2.40	100.53
RELIANCE EL	NYSE	643.09	34.98	30.24	0.00	409.43
REP STL	NYSE	2333.28	72.20	19.20	39.43	2071.12
REYNLDS MTL	NYSE	1679.26	60.02	17.62	33.40	2204.14
REYNLDS R J	NYSE	4837.64	338.67	478.57	34.67	3294.32
REYNLDS SEC	NYSE	118.73	8.79	10.13	0.00	279.49
ROBRTSHW CN	NYSE	193.28	2.94	2.16	9.36	146.73
ROSARIO RES	NYSE	59.22	10.16	6.36	2.31	80.51
SCOT LAD FD	NYSE	770.74	7.13	5.84	5.30	117.62
SCOVILL MFG	NYSE	443.07	12.91	12.41	14.88	384.38
SHAKESPEARE	NYSE	85.21	0.46	0.79	2.46	69.25
SHERWIN-WMS	NYSE	866.85	28.59	21.65	20.89	553.13
SMUCKER J M	NYSE	108.20	3.42	3.18	1.13	49.55
STANLEY WRK	NYSE	464.16	17.39	16.04	14.55	374.46
STD OIL-CH	NYSE	2484.16	126.56	60.40	20.55	4220.44
TEXAS INDS	NYSE	121.58	3.71	1.05	3.00	122.75
THOMAS INDS	NYSE	105.27	2.81	2.29	3.10	71.56

TIME INC	NYSE	910.66	45.05	30.90	0.00	759.81
TIMES MIRR	NYSE	799.48	47.24	41.21	16.06	642.38
TIMKEN CO	NYSE	804.49	61.32	56.69	22.61	655.21
TONKA CORP	NYSE	96.77	3.17	2.25	0.00	64.77
TRANSAMER	NYSE	2260.86	73.76	45.54	25.20	4896.25
TROPCANA PD	NYSE	162.56	12.78	10.87	2.20	106.95
TRW INC	NYSE	2585.68	103.90	80.41	82.76	1686.46
TX COMMERCE	NYSE	277.84	35.04	8.23	0.00	4523.52
U S INDS	NYSE	1566.68	18.17	8.03	38.80	1049.04
U S TOB CO	NYSE	142.72	15.87	16.25	2.39	135.28
UTD INDL CP	NYSE	76.18	2.06	1.59	3.10	48.62
V F CORP	NYSE	396.36	26.46	24.29	0.00	233.66
WACHOVIA	NYSE	255.39	28.93	4.78	0.00	3518.95
WANG LABS-B	NYSE	75.53	3.26	1.20	2.35	77.77
WARNER & SW	NYSE	251.89	6.02	3.05	5.74	231.15
WASH NATL	NYSE	415.08	15.23	1.62	0.00	912.78
WEATHERHEAD	NYSE	129.68	4.38	3.30	3.84	82.24
WEIL MCLAIN	NYSE	174.62	0.83	0.05	0.00	134.58
WESTN BANCP	NYSE	1497.74	84.67	32.50	25.85	8727.10
WHIRLPOOL	NYSE	1467.57	58.85	54.00	23.40	764.94
WHITE CONS	NYSE	1229.85	46.88	36.47	27.30	848.19
WHITE MOTOR	NYSE	1389.81	22.56	16.06	17.89	839.96
WIEBOLD STR	NYSE	148.18	1.32	0.35	6.50	84.94
WOLVERN W W	NYSE	125.59	1.93	1.49	5.22	65.66
ZURN INC	NYSE	235.24	4.79	4.70	4.92	151.56
ACME-HAMLTN	AMSE	30.71	0.04	0.06	0.71	18.18
AFFIL HOSP	AMSE	38.43	1.90	1.44	0.00	23.74

CLIENTS OF ERNST AND ERNST--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
ALTAMIL CP	AMSE	49.37	2.00	1.71	1.37	20.97
ALTEC CORP	AMSE	53.83	0.67	0.72	1.64	42.83
AM BILTRITE	AMSE	173.38	1.37	0.20	4.60	117.64
AMERICAN REC. GROUP	AMSE	60.63	-1.56	0.35	0.46	52.05
AMIC CORP.	AMSE	12.14	2.26	0.25	0.13	41.96
ANKEN INDS	AMSE	18.82	0.58	0.46	0.53	11.88
ANTHNY INDS	AMSE	70.05	1.91	1.79	0.00	34.11
APPLIED DEVICES	AMSE	3.41	0.10	0.11	0.44	5.48
ASHLND CAN	AMSE	174.88	15.00	14.60	3.00	256.51
ASFRO INC	AMSE	59.55	2.15	1.90	1.43	38.08
AZ-COLE INC	AMSE	149.04	-2.30	-3.57	0.00	162.99
BARRY WRGHT	AMSE	42.78	1.90	1.72	1.08	23.58
BARWICK IND	AMSE	169.50	-20.47	-2.30	3.94	106.48
BERVEN CARP	AMSE	43.05	-0.42	-0.52	0.00	34.16
BODIN APAR	AMSE	30.32	1.68	1.59	1.34	18.71
BROOKS &PRK	AMSE	32.64	0.99	0.82	0.85	12.92
BUNDY CORP	AMSE	96.53	4.36	3.38	2.68	71.01
CABLECOM-GEN	AMSE	21.81	2.63	1.76	1.51	41.15
CAP FOODS	AMSE	22.67	0.37	0.37	0.38	24.13
CARLON INDS	AMSE	76.56	14.35	6.63	1.72	80.74
CASTLTN IND	AMSE	33.34	1.62	1.49	0.00	41.03
CHATER MEDI	AMSE	50.69	1.45	1.35	3.19	60.46

CHC CORP	AMSE	22.58	1.11	0.98	1.47	18.34
CHILD WORLD	AMSE	59.05	2.17	2.26	1.00	20.22
CLARKE-GRAV	AMSE	65.00	2.77	2.81	0.00	37.40
CLAUSING CP	AMSE	28.41	2.04	2.04	0.43	18.04
COHEN-HATFD	AMSE	32.11	0.02	0.00	1.20	28.86
COLEMAN CO	AMSE	176.21	4.01	3.85	3.90	141.58
CONROY INC	AMSE	55.11	-1.60	-4.36	1.30	33.77
COOK ELECTR	AMSE	29.19	2.23	2.19	0.92	21.42
COOK PAINT	AMSE	92.98	0.59	0.19	1.71	47.99
CROSS A T	AMSE	41.90	5.36	4.30	0.00	25.53
CROWLEY MIL	AMSE	55.44	0.67	0.56	0.00	23.03
CROWN CENT	AMSE	475.25	5.50	2.78	0.00	206.30
CRYSTAL OIL	AMSE	160.25	4.51	3.77	0.81	77.75
CUBIC CORP	AMSE	92.40	2.69	2.53	0.00	48.33
DIAMND DRIL	AMSE	54.12	9.40	3.07	1.05	127.80
DILLARD DPT	AMSE	198.66	4.29	3.30	4.30	124.30
DIODES INC	AMSE	3.51	-0.86	-0.25	0.19	3.84
DRIVER HARR	AMSE	45.85	1.14	1.35	1.30	33.23
EASTN CO*	AMSE	43.44	2.64	2.13	0.87	24.63
ELCTRN RSCH	AMSE	1.52	-0.23	0.00	0.07	1.05
FRD RESOURC	AMSE	5.47	-0.69	0.00	0.28	25.01
FIRST S&L SHARES, INC.	AMSE	37.73	-1.92	0.35	0.31	507.43
FLAGG INDS	AMSE	10.38	0.66	0.68	1.42	27.47
FOX-STANLEY PHO PROD	AMSE	71.76	3.21	3.09	2.95	40.49
FRIEDMN IND	AMSE	41.80	3.72	3.43	0.08	11.74
FRONTR AIRL	AMSE	168.80	6.89	4.27	3.67	108.46
GARCIA CORP	AMSE	100.86	0.39	0.50	2.35	95.34

CLIENTS OF ERNST AND ERNST--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
GEN EMPLOY	AMSE	8.66	-0.14	-0.03	0.57	2.45
GLEN-GERY	AMSE	22.72	1.16	0.83	0.77	27.36
GORMAN-RUPP	AMSE	35.85	2.95	3.12	0.65	22.49
GROS TELCST	AMSE	6.39	1.12	1.13	0.00	10.65
GROW CHEM	AMSE	92.54	1.39	1.36	1.30	42.49
GRT LK CHEM	AMSE	44.29	6.51	4.10	0.00	42.83
GUARDSMN CH	AMSE	33.00	0.60	0.44	0.72	15.93
HARMAN INTL	AMSE	104.17	6.17	1.95	3.40	60.64
HARVEY GRP	AMSE	36.12	0.14	0.18	0.46	19.76
HORMEL GEO	AMSE	995.59	13.37	10.57	8.66	224.49
HOSPTLY MTR	AMSE	54.58	0.19	-1.02	4.40	63.11
HUCK MFG	AMSE	49.15	2.60	2.40	0.74	42.03
IMPERL INDS	AMSE	63.53	1.89	1.98	0.58	29.20
INARCO CORP	AMSE	18.48	-0.82	-0.70	0.50	14.30
INT'L BANKNOTE CO.,	AMSE	62.06	0.93	1.92	2.90	63.54
INTL COURIE	AMSE	37.52	4.07	4.12	1.95	27.07
INTL PRCTN	AMSE	81.42	-1.81	0.16	0.60	39.51
INTL STRTCH	AMSE	33.02	-4.52	0.00	0.77	21.35
KILLEARN PR	AMSE	1.93	-3.34	0.00	0.12	33.19
KIN-ARK CP	AMSE	23.66	0.81	0.52	0.00	27.44
LANECO INC	AMSE	81.07	0.94	0.97	1.56	24.40
LEA-RONAL	AMSE	66.97	1.98	1.88	0.12	16.11

LEIGH PRODS	AMSE	44.39	1.70	1.60	1.31	29.06
LOUSVLE CEM	AMSE	54.49	6.71	4.93	0.00	69.88
MAMMOTH MART, INC.	AMSE	143.48	-14.72	-0.88	3.00	57.81
MASLND C H	AMSE	116.97	1.60	1.33	1.88	62.66
MCDONOUGH	AMSE	265.97	10.57	6.99	9.12	144.03
MEANS F W	AMSE	85.29	3.20	2.95	3.90	53.34
NEW PROCESS	AMSE	174.97	11.33	12.45	1.70	55.80
NUCLEAR DAT	AMSE	19.45	0.65	0.80	0.43	11.63
OHIO ART CO	AMSE	22.66	0.67	0.60	0.55	15.39
OHIO BRASS	AMSE	105.01	7.45	6.04	0.00	63.93
ONAN CORP.	AMSE	114.68	8.43	4.94	2.78	101.03
ORIOLE HOME	AMSE	42.17	3.61	3.33	0.25	57.73
OVERHEAD DR	AMSE	98.59	3.82	3.20	0.00	60.56
PARAMNT PKG	AMSE	31.95	1.70	1.63	0.55	16.05
PATAGONIA CORP.	AMSE	41.68	-0.38	-1.31	0.73	458.58
PITTS-DES M	AMSE	193.65	4.08	4.46	3.90	95.48
PNEUMO CORP	AMSE	464.64	7.53	5.64	5.72	110.87
RAGAN BRAD	AMSE	111.84	4.92	5.27	2.40	58.83
RANSBURG CP	AMSE	30.96	3.23	1.66	0.70	32.95
RH MECL STP	AMSE	26.68	0.51	0.45	0.00	26.15
RISDON MFG	AMSE	54.22	0.55	0.36	1.86	41.92
ROBLIN INDS	AMSE	98.06	2.15	2.25	0.00	54.20
RPS RECL	AMSE	31.22	0.21	0.20	0.94	14.37
RUSSEL CORP	AMSE	102.66	6.35	5.36	5.30	80.38
SCHILLR INC	AMSE	13.67	0.67	0.61	0.49	11.23
SHELTER RES	AMSE	87.77	-16.02	0.00	1.48	73.71
SIGMA INSTR	AMSE	22.88	0.71	0.59	0.84	15.11

CLIENTS OF ERNST AND ERNST--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
SIKES CORP	AMSE	43.36	-2.68	-2.31	0.76	34.81
SPARTEK INC	AMSE	25.31	0.71	0.48	0.00	17.47
STD ALLIANC	AMSE	77.33	1.88	1.90	1.67	35.12
STP CORP	AMSE	65.27	3.75	3.43	0.35	54.22
SUNSHINE-JR	AMSE	47.84	1.41	1.27	0.97	11.18
TEJON RANCH	AMSE	13.78	1.42	1.11	0.08	26.53
TENNA CORP	AMSE	44.35	-0.01	0.19	0.00	25.61
THRIFTIMART	AMSE	314.91	0.72	0.32	3.12	60.18
TIDWEL INDS	AMSE	27.10	-2.71	-1.51	0.57	14.82
TRACOR INC	AMSE	103.73	2.83	3.11	4.00	57.42
TUFTCO CORP	AMSE	16.97	1.34	1.36	0.24	15.06
U & I INC	AMSE	237.43	5.74	3.46	1.04	142.13
U S REFLCT	AMSE	105.97	8.31	7.65	0.94	43.60
UNIV CIGAR	AMSE	10.76	0.77	0.11	0.39	9.38
VALLEY MTL	AMSE	5.26	0.21	0.26	0.10	3.43
VALMAC INDS	AMSE	107.63	0.91	0.15	2.53	91.60
VALSPAR CP	AMSE	59.36	1.32	1.11	1.01	29.14
VERMNT AMER	AMSE	76.45	4.64	4.37	0.00	47.48
VERTIPILE	AMSE	8.63	-0.72	-0.58	0.17	8.39
VISHAY INTR	AMSE	15.78	1.19	0.68	0.85	18.93
WALCO CORP	AMSE	104.96	2.91	2.91	2.74	47.49
WEIMAN CO	AMSE	34.33	0.13	0.08	0.83	18.99
WHITEHL CP	AMSE	30.90	1.08	1.01	1.82	17.18

CLIENTS OF TOUCHE ROSS & CO.

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
ALBERTSONS	NYSE	1046.10	11.70	11.40	16.46	172.80
ALEXANDRS INC	NYSE	345.64	4.06	3.58	11.00	163.15
ALLIED STRS	NYSE	1595.74	36.34	30.73	58.50	1032.90
AM HOIST &D	NYSE	359.16	11.41	4.96	7.34	269.04
AM HOSP SUP	NYSE	1143.44	55.18	39.43	24.80	725.30
AM MOTORS	NYSE	2282.20	-27.50	-8.00	32.94	1010.35
APL CP	NYSE	106.72	6.34	6.08	1.95	72.63
ARK LA GAS	NYSE	322.16	39.26	24.57	4.42	672.33
ARMOUR & CO.	NYSE	2594.21	27.94	22.81	19.00	684.43
ASSD DRY GD	NYSE	1300.19	37.36	35.50	55.00	750.73
AUTOMC DATA	NYSE	154.68	13.85	13.33	5.40	105.68
BLAIR JOHN	NYSE	96.20	2.51	2.69	0.00	56.47
BLOCK H&R	NYSE	110.52	17.54	17.44	30.50	93.91
BOEING CO	NYSE	3718.85	76.35	36.40	72.60	1788.90
BUCY-US-ERI	NYSE	353.14	29.88	21.47	7.33	454.28
BUNDY CORP	NYSE	126.74	8.81	8.10	3.88	102.01
C I T FINL	NYSE	554.68	90.38	54.46	22.50	4330.92
CALIF FIN CORP.	NYSE	56.07	-0.57	1.09	0.47	723.85
CASCADE NAT	NYSE	91.47	3.63	2.79	0.00	110.16
CHELSEA INC	NYSE	171.36	1.75	2.27	2.46	107.81
CHRYSLER CP	NYSE	1598.40	-207.21	26.40	217.59	6266.73
COAST ST GS	NYSE	1874.15	54.30	37.00	4.86	1713.75

COMPTR SCI	NYSE	177.35	3.65	3.58	5.00	98.34
DE SOTO INC	NYSE	249.29	2.82	1.75	6.80	135.05
ELGIN NATL*	NYSE	73.61	0.88	1.03	1.20	60.84
EVANS PRDS	NYSE	774.30	12.66	9.50	12.30	565.29
FAIRCHLD IN	NYSE	252.39	6.02	5.20	7.70	144.18
FEDT DEPT	NYSE	3269.11	119.01	119.00	89.22	1613.92
FLEMING CO	NYSE	1566.38	11.67	10.79	6.82	174.22
FOXBORO CO	NYSE	305.31	18.31	16.30	0.00	250.35
FRUEHAUF CP	NYSE	1314.97	22.73	10.60	26.36	1020.86
FST CHARTER	NYSE	377.26	50.22	29.39	1.80	5077.94
GOLDEN WEST FIN CORP.	NYSE	69.38	7.84	4.36	0.37	869.75
GREYHND CP	NYSE	3733.29	81.22	45.22	53.44	1427.96
INTERSTATE STORES, INC.	NYSE	188.26	3.66	4.80	3.95	150.10
IOWA BEEF	NYSE	1805.34	23.24	19.78	6.65	229.68
JEWEL COS	NYSE	2598.91	30.23	17.98	52.73	749.18
KAISER CEM	NYSE	186.25	3.39	-3.25	2.88	233.96
KELLWOOD CO	NYSE	383.56	0.42	0.14	16.50	250.32
LENOX INC	NYSE	123.16	7.71	5.64	4.50	84.33
LIBBY, MCNEILL & LIBBY	NYSE	474.79	9.82	6.44	6.14	353.68
LITTON INDS	NYSE	3430.17	35.28	32.37	97.00	2185.73
MACY R H	NYSE	1297.67	27.14	24.00	38.00	777.17
MEAD CORP	NYSE	1244.64	52.78	25.69	24.00	1091.21
MEDIC COMP SYS, INC.	NYSE	6.04	0.62	0.56	0.12	2.53
MUNFORD INC	NYSE	273.16	4.29	3.35	0.00	102.87
NATL CAN CP	NYSE	799.09	18.73	18.13	12.81	415.99
NATL CTY LN	NYSE	47.37	-0.35	-0.33	0.00	93.15
NATL DETROIT	NYSE	490.17	53.62	17.73	5.51	7347.22

CLIENTS OF TOUCHE ROSS & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
NATL INDS	NYSE	759.09	16.21	18.61	6.90	281.41
NUCOR CORP	NYSE	121.47	7.58	4.10	2.30	92.64
OXFORD INDS	NYSE	260.81	8.24	7.36	10.67	125.67
PAMIDA INC	NYSE	202.17	6.63	6.48	4.20	78.01
PILLSBURY CO	NYSE	1197.43	30.92	29.42	27.00	670.83
RELIANCE GP	NYSE	873.82	-16.05	-7.11	9.00	1497.58
ROHR INDS	NYSE	456.26	-5.46	-7.10	13.10	313.80
RONSON CORP	NYSE	131.91	-9.60	0.83	5.23	95.75
ROPER CORP	NYSE	347.45	5.38	4.34	6.00	208.57
RTE CORP	NYSE	85.33	1.63	2.40	1.26	43.30
SAFEGUARD	NYSE	90.21	1.51	1.55	0.00	65.16
SALANT CORP	NYSE	165.30	3.02	2.87	9.40	94.25
SAV-ON-DRUG	NYSE	293.83	6.14	6.13	0.00	80.07
SEARS ROE	NYSE	3101.20	511.39	304.20	437.00	1339.40
SKIL CORP	NYSE	117.72	0.70	1.02	4.27	111.19
SOLA BASIC	NYSE	168.85	7.02	5.94	4.98	108.44
SOS CONS	NYSE	86.59	4.61	5.00	1.70	46.88
SQUARE D CO	NYSE	460.36	35.86	32.86	0.00	312.09
STARRETT CO	NYSE	55.71	5.21	5.52	2.12	51.05
SUPER GENL	NYSE	1498.47	2.67	0.81	27.00	309.27
SUPER VALU	NYSE	1641.74	11.06	10.83	9.26	192.92
TESORO PET	NYSE	815.78	42.93	22.08	4.00	589.71

TEXAS OIL	NYSE	250.11	40.11	8.40	1.13	438.74
TRANS-WORLD FIN CO.	NYSE	56.68	4.26	1.69	0.49	697.12
UNISHOPS, INC.	NYSE	112.98	0.20	0.54	2.50	41.92
VENICE INDS	NYSE	45.88	0.35	0.75	1.82	34.28
WILBILT CORP.	NYSE	24.49	-1.87	0.17	0.56	18.80
WYOMING BANCORP	NYSE	23.46	2.41	0.22	0.42	277.09
ZALE CORP	NYSE	600.22	30.14	23.13	17.71	450.76
AERONCA INC	AMSE	50.90	0.61	0.69	1.20	36.93
AIRBORNE FREIGHT CORP.	AMSE	113.01	3.46	3.23	1.95	29.86
AM PRECN	AMSE	20.29	0.90	0.94	0.00	9.36
AQUITAIN CO	AMSE	65.01	21.45	15.30	0.00	272.43
ARUNDEL CP	AMSE	41.15	-4.43	0.37	0.75	73.27
BARCLAY INC	AMSE	20.35	0.08	0.03	0.40	10.03
BARCO-CALIF	AMSE	18.28	1.04	1.12	0.70	11.42
BARNWELL	AMSE	2.96	0.16	0.26	0.03	13.60
BERG ENTERPRISES, INC.	AMSE	25.13	-0.70	-0.50	1.62	38.66
BIG V SUPER	AMSE	162.18	1.51	1.28	1.74	22.64
BLESSING CP	AMSE	46.99	-4.39	0.72	1.70	21.66
BOMAINE CORP.	AMSE	19.29	-3.00	0.18	0.39	16.09
BRANCH INDS	AMSE	92.94	1.20	1.17	2.74	42.29
BUTLER INTL	AMSE	90.12	2.60	2.30	1.29	30.59
BUTTES GAS	AMSE	72.06	24.72	13.18	1.34	197.52
CERTRN CORP	AMSE	14.36	-0.58	0.00	0.77	12.04
CHADWK-MILR	AMSE	14.54	0.76	0.84	0.23	9.47
CHB FOODS	AMSE	147.81	4.37	4.10	0.00	55.05
CHRISTNA CO	AMSE	15.47	0.15	0.11	0.10	41.96
CITY GAS CO OF FLORIDA	AMSE	16.86	1.23	1.09	0.27	40.37

CLIENTS OF TOUCHE ROSS & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
CLOPAY CORP	AMSE	65.13	0.17	-0.08	1.30	35.85
CONL METAL	AMSE	471.77	9.38	8.80	2.10	120.26
COMPAC CORP	AMSE	12.20	0.47	0.19	0.11	4.04
COMPO INDS	AMSE	22.38	-0.67	-0.06	0.51	17.71
COTT CORP	AMSE	75.91	0.81	0.82	0.00	27.33
CREST-FOAM	AMSE	13.09	-0.41	-0.35	0.25	7.11
CRS DESIGN	AMSE	28.37	1.95	1.13	0.76	18.82
DELTWN FOOD	AMSE	106.10	1.06	0.56	1.00	32.24
DIXILYN CP	AMSE	21.41	4.58	1.53	0.49	30.29
EDWARDS (A.G.) & SONS	AMSE	49.58	2.99	2.47	1.54	104.94
EVANS-ARIST	AMSE	13.03	0.85	0.35	0.00	6.82
FIN CORP. SANTA BARBARA	AMSE	51.59	3.26	1.96	0.37	673.48
FRIGITRONIC	AMSE	40.68	1.27	1.38	1.49	18.34
GARLND CORP	AMSE	45.59	-3.14	-3.03	1.60	20.14
GAYNOR-STAF	AMSE	41.79	-3.69	0.00	0.53	39.22
GOOD (L S)	AMSE	87.86	-0.25	-0.86	5.00	39.06
GORIN STORE	AMSE	60.76	0.30	0.23	2.89	34.84
GRUEN INDS*	AMSE	14.85	-2.78	-0.04	0.25	12.55
HAMPTN INDS	AMSE	56.44	1.85	1.89	3.10	28.15
HEALTH INDUSTRIES, INC.	AMSE	46.19	-8.56	-6.68	2.00	38.09
HOLSTN CEML	AMSE	55.82	17.10	8.45	0.24	186.88
HOWELL INDS	AMSE	26.86	1.61	1.61	0.40	9.34

ICB CORP.	AMSE	0.46	-3.03	-0.21	0.24	20.41
JACLYN INC	AMSE	32.10	1.86	1.88	1.40	11.21
JUNIPR PETE	AMSE	5.59	1.51	1.10	0.03	14.49
KAISER INDS	AMSE	1016.21	76.66	23.11	0.00	1292.90
KUHNS BIG K	AMSE	181.73	3.60	3.46	4.91	45.14
LLOYDS ELEC	AMSE	84.80	-2.96	-2.03	0.49	44.98
LOEHMANN'S	AMSE	69.67	2.56	2.52	1.90	15.75
LOGISTICS	AMSE	24.11	-0.16	-0.47	0.55	17.07
MASONEILAN	AMSE	66.55	4.18	4.25	2.80	59.10
MDC CORP	AMSE	6.44	0.32	0.21	0.10	28.12
MEDCO JEWLRY	AMSE	44.47	-0.12	-0.17	1.45	27.99
NAT SYSTEMS	AMSE	8.63	0.10	0.13	0.41	11.40
NOVO CORP	AMSE	129.35	0.50	0.62	3.20	66.97
OZARK AIRL	AMSE	132.43	0.55	0.15	2.90	102.83
PARK ELECTR	AMSE	29.18	-0.19	-0.19	0.75	14.32
PATRICK PET	AMSE	41.33	5.15	0.00	0.00	49.85
PELLGRIN PRO	AMSE	23.64	-1.54	0.00	0.70	21.95
READING INC	AMSE	50.31	-3.29	-0.29	0.45	22.84
RESTAUR ASC	AMSE	52.65	-0.88	0.00	3.60	29.75
SAMBOS REST	AMSE	133.03	17.64	13.04	0.00	111.79
SCHICK INC	AMSE	72.57	-7.74	0.64	0.84	39.00
SEA CONT	AMSE	41.51	7.49	2.30	0.27	137.32
SEASON-ALL	AMSE	23.60	0.78	0.78	0.65	11.50
SHENANDH LP	AMSE	33.63	2.74	2.74	0.86	29.36
SHOPWEL INC	AMSE	226.62	-1.00	-0.94	5.15	47.19
SUPR SURGL	AMSE	34.75	0.44	0.33	0.00	27.94
SYSCO CORP	AMSE	521.79	8.30	8.11	3.40	111.24

CLIENTS OF TOUCHE ROSS & CO.--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
TOWN-CTRY	AMSE	7.26	-1.27	-0.60	0.16	4.12
TURBODYN CP	AMSE	105.52	0.02	-0.35	2.82	88.19
UNIV CONT	AMSE	45.86	0.47	0.32	1.65	24.25
UNIV-RUNDL	AMSE	58.23	1.63	1.43	1.40	38.99
VALLEY INDS	AMSE	116.86	14.83	14.73	1.45	65.54
VULCAN INC	AMSE	90.30	3.89	3.76	0.00	42.69

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CLIENTS OF OTHER CPA FIRMS

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
AILEEN INC	NYSE	74.02	1.51	0.88	4.00	80.19
AIRBORN FGT	NYSE	113.01	3.46	3.23	1.90	29.86
AM BLDG	NYSE	135.25	3.15	3.05	14.30	42.12
AM MEDICORP	NYSE	274.73	10.38	8.23	12.15	390.37
AM SEATING	NYSE	104.84	2.43	2.42	2.64	62.91
AMES DEPT	NYSE	114.05	2.29	1.94	2.45	31.73
AMETEK INC	NYSE	224.08	12.70	12.67	5.37	120.96
AMREP CP	NYSE	57.44	-1.71	-1.95	1.30	128.02
ARLEN RLTY	NYSE	838.11	-46.46	-7.34	18.90	1305.19
ARVIN INDS	NYSE	340.31	4.77	4.77	3.50	228.27
AVNET INC	NYSE	541.46	26.30	26.73	8.00	283.18
AVON PRODS	NYSE	1295.06	139.00	141.99	25.00	815.54
BARNES GRP	NYSE	212.44	8.43	9.62	5.42	121.37
BAXTER LABS	NYSE	564.08	44.47	11.12	25.70	685.01
BAY ST GAS	NYSE	84.71	6.15	3.28	0.92	153.42
BELDEN CORP	NYSE	155.11	4.08	3.43	3.20	90.96
BELDING HEM	NYSE	105.03	3.21	2.31	3.00	62.06
BENGUET CSL	NYSE	39.85	6.37	3.60	10.33	62.31
BERKEY PHOT	NYSE	130.95	-6.96	0.39	4.52	127.50
BEST PROD	NYSE	208.83	2.03	1.30	4.97	85.92
BOBBIE BRKS	NYSE	175.70	-5.73	-0.68	5.00	92.45
BOOK-MONTH	NYSE	62.71	4.35	4.74	0.80	42.92

BR PETR	NYSE	8354.00	1118.00	4161.00	0.00	5108.00
BROCKWAY GL	NYSE	354.64	17.82	16.13	10.90	245.53
CAESARS WLD	NYSE	116.55	2.10	1.57	4.04	191.89
CAMPBL R&D	NYSE	29.47	11.37	7.73	0.32	41.14
CENCO INC	NYSE	267.11	-6.80	-4.98	10.00	244.78
CENTRON CIT	NYSE	41.25	7.28	4.06	0.72	40.62
CERTAIN TD	NYSE	552.98	29.65	21.59	9.14	428.87
CONE MILLS	NYSE	462.29	24.24	16.53	14.40	273.45
CONGOLEUM	NYSE	395.86	9.56	8.58	10.52	229.85
CPC INTL	NYSE	2741.50	109.20	102.70	42.90	1407.00
CTS CORP	NYSE	121.00	8.28	8.37	6.33	87.52
DIEBOLD INC	NYSE	195.18	7.19	7.32	5.35	149.63
DOME MINES	NYSE	59.01	19.41	10.53	1.46	122.21
DRAVO CORP	NYSE	749.62	11.67	9.00	15.00	331.89
EASTN UTIL	NYSE	130.59	5.07	0.69	1.26	269.97
EDISON BROS	NYSE	489.59	23.96	26.18	14.40	190.05
EL PASO CO	NYSE	1389.35	58.21	78.44	11.76	2410.10
EMI LTD	NYSE	930.48	31.33	43.44	46.60	928.19
EMPIRE GAS	NYSE	72.02	5.57	5.19	1.21	62.37
ENSERCH CP	NYSE	716.57	48.12	29.94	7.10	1102.16
ESQUIRE INC	NYSE	78.82	1.89	1.63	1.30	70.15
FED NAT MTG	NYSE	2440.58	114.96	110.20	0.00	1596.21
FOOD FAIR	NYSE	2482.54	-3.43	-4.05	35.00	429.22
FOSTER WHLR	NYSE	1020.87	14.13	13.49	16.65	441.02
FST MTG INV	NYSE	48.00	-160.27	0.00	0.00	532.82
FST NAT ST	NYSE	145.07	13.50	2.11	2.63	2202.52
GEN CINEMA	NYSE	358.45	14.87	13.45	9.67	203.49

CLIENTS OF OTHER CPA FIRMS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
GEN DEVELOP	NYSE	130.34	10.99	11.26	3.80	366.11
GINOS INC	NYSE	247.17	7.72	7.69	0.00	103.68
GRAINGER WW	NYSE	327.70	19.54	19.46	3.77	183.24
GRANITVL CO	NYSE	211.77	9.22	6.20	6.63	116.72
GRUMMAN CP	NYSE	1328.62	23.55	17.80	28.00	522.10
GULTON INDS	NYSE	98.95	0.95	0.86	3.69	62.24
HALL FRANK	NYSE	101.44	11.78	13.74	0.00	299.43
HANDY & HAR	NYSE	338.44	12.71	12.97	2.65	146.53
HARRAHS	NYSE	127.82	10.57	8.90	6.40	113.92
HARRIS BANK	NYSE	282.55	30.24	8.32	3.07	4196.77
HECKS INC	NYSE	151.06	5.36	4.58	0.00	62.31
HEWLETT-PCK	NYSE	981.17	83.58	65.01	30.20	767.71
HILLENBRAND	NYSE	126.17	12.98	13.24	3.15	88.62
HILTON HOTL	NYSE	351.12	42.38	25.32	24.00	410.24
HOSP AFFIL	NYSE	104.43	4.12	3.41	10.00	131.20
HUDSN B MIN	NYSE	259.63	14.77	36.63	0.00	517.77
HUGHES &HAT	NYSE	76.83	1.51	1.39	2.50	45.71
HUNT (PHIL)	NYSE	56.36	3.59	2.77	0.88	45.20
IDEAL TOY	NYSE	124.84	3.33	3.29	4.66	73.23
INCO LTD	NYSE	1694.77	186.89	135.21	53.52	3025.67
INTERCON DV	NYSE	36.79	5.65	0.00	1.26	131.15
JEFF-PILOT	NYSE	438.14	58.13	26.28	0.00	1954.33

JONATHN LGN	NYSE	320.79	5.85	1.71	11.50	252.66
KANE-MILLER	NYSE	657.50	10.19	8.41	5.11	176.46
KATY INDS	NYSE	164.27	5.40	4.75	5.33	166.62
KLM ROYAL D	NYSE	889.02	-27.24	0.00	16.77	944.19
KORACORP	NYSE	128.61	2.17	3.03	4.90	65.59
KROEHLR MFG	NYSE	134.73	-1.71	-1.74	0.00	81.42
KYSOR INDL	NYSE	102.78	0.79	0.18	2.37	73.96
LESLIE FAY	NYSE	138.64	3.15	2.73	3.00	62.38
LEVITZ FURN	NYSE	355.32	3.91	3.05	4.99	150.61
LIBERTY CP	NYSE	139.95	14.91	7.39	0.00	619.05
MACDONALD	NYSE	132.03	1.93	1.56	1.30	64.96
MASSEY-FERG	NYSE	2513.30	94.68	47.87	64.57	1982.03
MCDERMT J R	NYSE	742.82	76.08	14.12	18.35	849.50
MCNEIL CORP	NYSE	149.89	3.35	2.06	0.00	131.41
MOHAWK RUBR	NYSE	146.71	4.42	3.59	2.25	91.06
MOLYCORP	NYSE	59.08	7.47	3.73	0.00	134.14
MORSE ELCTR	NYSE	142.97	-9.88	-11.37	1.83	124.63
MYERS (L E)	NYSE	77.24	-1.31	-0.92	0.00	41.55
NATL MEDICL	NYSE	90.23	4.09	3.84	5.00	147.81
NATL STARCH	NYSE	274.72	18.34	13.50	3.45	185.39
NO AM PHIL	NYSE	1409.84	31.02	19.60	0.00	887.87
NO CENT AIR	NYSE	163.58	5.22	-0.34	3.41	134.14
NORTHGT EXP	NYSE	33.80	1.16	0.34	0.00	57.09
NORTHROP CP	NYSE	853.29	18.14	15.28	26.20	424.03
OPELIKA MFG	NYSE	48.21	1.43	1.26	2.20	37.78
ORNG-ROCK	NYSE	207.00	19.72	5.92	1.62	438.90
OVERSEA SHI	NYSE	135.63	37.62	-0.72	0.00	485.98

CLIENTS OF OTHER CPA FIRMS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
PAC LUMBER	NYSE	127.78	21.53	12.10	0.00	130.84
PAC PETE	NYSE	288.04	57.27	43.79	0.00	639.94
PARKER DRIL	NYSE	111.99	12.08	7.67	4.50	150.34
PENN-DIXIE	NYSE	260.91	-2.24	-1.66	4.70	216.70
PETRIE STR	NYSE	277.82	27.79	29.50	0.00	134.86
PFIZER INC	NYSE	1665.46	147.72	66.60	39.20	2019.38
PHILLIP-VAN	NYSE	316.23	-1.30	-1.66	13.30	181.80
PICKWICK	NYSE	227.21	7.22	7.27	3.41	109.80
PLESSEY CO	NYSE	771.93	33.70	29.88	0.00	996.17
PURITAN FSH	NYSE	183.01	0.47	0.39	5.70	97.50
RAYBESTOS-M	NYSE	210.70	7.76	5.59	5.78	143.38
REEVES BROS	NYSE	187.76	3.09	2.63	6.07	108.11
RITE AID	NYSE	342.97	6.93	7.61	5.87	125.50
ROBINS A H	NYSE	241.06	26.63	23.10	4.75	223.54
RUCKER CO	NYSE	161.22	16.28	14.96	2.09	111.39
RUSS TOGS	NYSE	139.26	7.11	7.52	3.00	64.23
SAUL (BF)	NYSE	32.75	-20.19	0.00	0.00	354.35
SAXON INDS	NYSE	434.26	5.83	4.30	6.82	325.10
SHAPELL IND	NYSE	108.43	5.62	6.17	0.36	120.46
SKAGGS COS	NYSE	625.69	13.23	11.59	9.76	152.48
SMITH TRANS	NYSE	135.15	4.79	4.25	4.47	92.39
SPERRY HTCH	NYSE	581.78	13.90	4.82	17.00	628.69

SPRAGUE EL	NYSE	161.86	-11.73	-1.11	9.50	141.87
STERCHI BRO	NYSE	29.47	0.94	0.94	0.83	30.25
STEVENS J P	NYSE	1122.97	19.90	16.60	44.40	755.59
STHLND CORP	NYSE	1787.93	34.32	34.46	28.60	536.98
STONE CONT	NYSE	217.29	11.65	11.27	3.73	151.80
SUCREST CP	NYSE	416.43	2.55	2.69	1.30	105.33
SUNSTRND CP	NYSE	508.70	21.97	10.21	0.00	522.97
SUPERSCOPE	NYSE	157.23	9.92	7.71	2.56	122.69
TECHNICARE	NYSE	71.20	3.54	3.25	1.36	63.59
TECHNICOLOR	NYSE	135.81	3.05	2.66	3.70	84.40
TELECOR INC	NYSE	62.26	2.35	1.85	0.25	34.63
TEXAS UTILS	NYSE	726.60	139.13	82.54	9.64	2769.07
TISHMAN RLT	NYSE	85.23	-16.97	0.54	0.95	296.37
TOBIN PCK	NYSE	104.45	-5.67	-0.01	1.30	20.58
TRIANGL IND	NYSE	257.36	8.07	9.59	0.00	138.66
UNILEVR LTD	NYSE	5662.65	158.92	189.54	0.00	2865.90
UNION CAR	NYSE	5665.00	381.70	343.20	106.48	5740.80
UTD INNS	NYSE	75.19	2.77	2.04	4.09	83.86
UTD MRCHNTS	NYSE	921.08	-18.47	-6.95	32.00	1055.69
VICTOR COMP	NYSE	210.11	-5.67	-3.81	6.00	157.74
WEAN UNITED	NYSE	298.46	5.06	4.60	5.21	190.37
WHITING CP	NYSE	76.33	3.72	3.80	1.55	40.08
WINBAGO IND	NYSE	112.15	-2.48	-2.72	2.65	88.30
WISC PWR&LT	NYSE	196.57	21.12	22.22	0.00	509.22
WITCO CHEM	NYSE	527.73	13.86	15.77	5.00	300.82
ABERDN MFG	AMSE	62.45	1.06	0.96	1.90	39.73
ABERDN PETE	AMSE	0.99	0.34	0.14	0.00	2.90

CLIENTS OF OTHER CPA FIRMS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
ACTION INDS	AMSE	43.44	0.89	0.98	0.57	31.12
ADAMS RUSEL	AMSE	14.52	0.39	0.33	0.51	15.74
ADM INDS	AMSE	13.17	-2.76	0.01	0.38	7.93
AERODEX INC	AMSE	14.30	0.00	0.01	0.42	14.27
AFTER SIX	AMSE	54.58	1.21	1.32	1.65	41.82
AIC PHOTO	AMSE	28.89	-1.19	-0.17	0.70	22.26
ALBA-WALDEN	AMSE	21.73	0.63	0.01	1.18	15.85
ALLINC TIRE	AMSE	58.00	3.37	1.88	0.00	65.11
ALPHA INDS	AMSE	7.80	-0.17	-0.04	0.31	5.78
ALTERMAN FD	AMSE	288.06	2.40	1.97	3.30	58.89
AM AGRONOMC	AMSE	20.76	2.16	2.03	0.39	49.50
AM CONTROLD	AMSE	13.99	0.22	0.38	0.00	16.05
AM ISRAELI	AMSE	49.33	4.72	2.53	0.00	59.35
AM SAFETY	AMSE	84.10	2.03	1.10	3.39	45.50
ANDREA RAD	AMSE	2.37	0.22	0.02	0.10	3.19
ASAMERA OIL	AMSE	15.58	9.40	0.36	1.50	52.52
ASKIN SERV	AMSE	10.09	-0.36	-0.68	0.43	7.57
ASTREX INC	AMSE	30.02	-1.07	-0.76	0.00	15.85
ATI INC	AMSE	47.86	-0.24	0.03	0.95	19.56
ATLAS CONS	AMSE	119.47	21.89	0.15	7.48	191.23
AUTO-TRAIN	AMSE	28.50	0.25	0.10	0.61	22.41
AUTOMC SERV	AMSE	81.29	1.06	0.95	0.68	18.94

BAKER MICHL	AMSE	31.37	0.70	0.72	0.00	16.61
BARTELL MED	AMSE	32.46	-3.70	0.17	0.29	21.27
BARTNS CNDY	AMSE	14.14	0.12	0.12	0.70	10.19
BELSCOT RET	AMSE	46.38	0.04	0.07	1.20	16.13
BETHLM CORP	AMSE	13.19	0.32	0.30	0.43	9.70
BIG BEAR	AMSE	288.13	5.59	4.64	5.05	63.46
BIG DADDYS	AMSE	53.43	1.36	1.10	0.83	18.28
BOWNE & CO	AMSE	45.32	3.04	3.14	1.04	27.37
BR-AMER TOB	AMSE	5475.62	279.79	240.85	150.00	4747.66
BRASCAN LTD	AMSE	799.42	119.22	30.82	31.56	1919.41
BRODY B ST	AMSE	14.05	-0.31	-0.32	0.50	5.98
CAGLES INC	AMSE	107.28	-4.60	-2.33	1.50	29.12
CALDOR INC	AMSE	195.35	5.23	5.10	4.50	62.22
CAMPBL CHIB	AMSE	14.16	-2.10	-1.37	0.49	40.59
CANVRL INTL	AMSE	2.46	-0.59	0.00	0.00	15.27
CAP RESERVE	AMSE	13.34	-2.92	-1.12	0.60	19.52
CAPEHART CP	AMSE	57.30	-3.99	-3.58	2.17	55.95
CENTURY FAC	AMSE	8.46	0.24	0.29	0.00	50.28
CENVIL COMM	AMSE	34.67	-8.42	-7.79	0.41	40.76
CHI RIVET	AMSE	23.35	1.36	0.82	0.00	21.89
CINEMA 5	AMSE	9.45	0.33	0.24	0.40	7.31
CITATION CO	AMSE	36.86	-1.09	0.55	1.00	28.49
CLARK CONS	AMSE	22.69	0.59	0.60	0.32	9.09
CLAROSTAT	AMSE	13.99	0.46	0.43	0.84	8.42
CMT INDS	AMSE	6.12	0.06	0.21	0.11	5.29
CND HYDROCN	AMSE	242.75	4.88	6.87	2.54	204.05
COACHMN INC	AMSE	107.47	4.01	4.04	2.16	33.23

CLIENTS OF OTHER CPA FIRMS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
COMINCO LTD	AMSE	746.18	73.62	74.70	11.82	869.51
COML ALLIAN	AMSE	28.14	3.72	1.48	0.17	199.85
COMNTY PSYC	AMSE	16.76	1.80	1.89	0.85	26.78
CONCORD FAB	AMSE	82.22	3.68	3.76	0.40	38.93
CROMPTON CO	AMSE	64.56	-2.62	-4.14	3.60	90.78
CW TRAN INC	AMSE	58.77	2.15	1.76	1.81	33.48
DAMON CREAT	AMSE	49.29	-0.08	-0.04	1.25	19.90
DAY MINES	AMSE	5.02	-0.74	-0.88	0.00	9.73
DE JUR AMSC	AMSE	5.39	0.11	0.09	0.00	5.94
DEN-TAL-EZ	AMSE	21.80	1.24	0.94	0.42	24.83
DEV CORP AM	AMSE	63.24	-3.96	-3.76	0.35	83.89
DOME PETE	AMSE	234.67	41.12	23.89	0.78	613.68
DOMTAR LTD	AMSE	815.22	35.29	23.90	17.64	721.37
DONNKENNY	AMSE	52.44	1.76	1.84	2.20	17.52
DRUG FAIR	AMSE	200.40	1.99	1.74	5.34	55.89
DUNLOP HLDG	AMSE	2061.94	23.46	56.73	105.00	1789.38
DUPLEX PROD	AMSE	73.52	4.65	4.86	0.99	35.42
DURO-TEST	AMSE	45.32	3.31	3.16	1.90	33.61
DYNAMC CORP	AMSE	90.59	2.14	1.97	2.50	39.04
DYNELL ELEC	AMSE	28.07	0.29	0.06	0.63	15.39
EAGLE CLOTH	AMSE	55.27	-1.79	0.02	1.80	44.24
EAZOR EXPRS	AMSE	37.53	0.79	0.29	1.19	21.17

EDMCS CORP	AMSE	38.83	-0.31	-0.50	0.80	33.31
EHRENREICH	AMSE	70.88	1.97	1.67	0.60	56.30
ELCTRNS CP	AMSE	28.49	1.70	0.60	0.90	35.37
ELECTRO AUD	AMSE	43.08	-0.78	-0.95	1.35	47.52
ERO INDS	AMSE	15.98	-0.40	-0.41	0.47	9.17
ESQUIRE RAD	AMSE	28.89	0.83	0.91	0.23	14.66
EXECUTONE	AMSE	22.16	0.26	0.29	0.55	25.25
FAB INDS	AMSE	51.88	2.04	2.05	1.15	33.44
FABIEN CORP	AMSE	4.60	0.24	0.17	0.18	3.21
FAIR-TEX M	AMSE	25.02	-0.97	-1.05	1.10	21.80
FAIRFLD NBL	AMSE	53.95	-0.58	-0.82	0.00	34.36
FAIRMT CHEM	AMSE	6.78	0.30	0.07	0.00	4.67
FAMILY DOLR	AMSE	53.19	1.35	1.22	2.06	21.64
FAMILY RECD	AMSE	12.21	0.45	0.18	0.00	8.13
FASH FABRIC	AMSE	38.39	-10.86	-1.58	0.86	14.80
FAYS DRUG	AMSE	61.49	0.47	0.46	1.12	16.79
FELSWAY CP	AMSE	48.59	1.36	1.01	1.45	29.64
FIELDS PLAS	AMSE	7.04	-0.84	0.00	0.18	7.11
FITCHBURG	AMSE	20.14	0.92	0.14	0.22	37.77
FLA CAPITAL	AMSE	18.94	0.64	0.39	0.00	14.88
FLAVRLD INC	AMSE	301.77	-0.40	-0.57	0.80	56.07
FLOCK INDS	AMSE	9.08	-0.39	-0.37	0.19	9.33
FLUKE JOHN	AMSE	41.51	3.12	2.68	1.06	25.34
FOODARAMA	AMSE	319.55	1.63	1.61	3.65	33.42
FORD MTR-C	AMSE	4259.40	154.30	114.80	38.09	1462.30
FOREST CITY	AMSE	144.43	-2.00	-1.05	2.52	112.20
FOREST LABS	AMSE	3.66	0.38	0.32	0.10	6.04

CLIENTS OF OTHER CPA FIRMS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
FOX-STANLEY	AMSE	71.76	3.21	3.09	3.20	40.49
FPA CORP	AMSE	23.98	-0.35	-0.35	0.34	84.16
FRIEND FRST	AMSE	39.45	0.16	0.14	0.38	14.27
FRIER INDS	AMSE	26.48	-0.14	-0.13	1.60	15.11
FRISCH REST	AMSE	67.28	1.48	1.45	5.30	31.74
GARAN INC	AMSE	78.99	3.42	3.09	3.60	43.81
GAYLRD NATL	AMSE	81.34	0.12	0.09	2.00	26.64
GEARHRT-OWN	AMSE	45.43	3.87	3.65	1.23	38.83
GEN BUILDRS	AMSE	6.55	-0.49	-0.29	0.09	17.90
GEN RES CP	AMSE	1.03	-0.75	0.03	0.00	19.58
GENERICS CP	AMSE	19.24	0.65	0.70	0.00	17.65
GIANT FOOD	AMSE	741.04	6.98	6.15	11.80	156.63
GIANT YELLW	AMSE	15.38	0.31	0.39	0.00	11.19
GLOSSER BRO	AMSE	89.91	1.75	1.83	1.70	18.35
GLOVER INC	AMSE	155.42	0.08	-0.16	0.95	24.55
GOLDFLD CP	AMSE	23.57	0.12	0.15	0.00	14.19
GRAND AUTO	AMSE	44.94	0.53	0.48	0.00	20.38
GREENMN BRO	AMSE	66.92	0.63	0.73	0.65	27.97
GREER HYDRL	AMSE	17.48	1.32	1.44	0.00	13.86
GREYHND CMP	AMSE	52.13	0.95	-3.16	0.50	173.82
GULF OIL-C	AMSE	1701.20	176.60	143.70	10.70	1726.50
GULFSTRM LD	AMSE	136.25	-2.32	-2.86	1.24	173.74

HALCO PRODS	AMSE	19.25	0.08	0.07	0.40	8.59
HAMPSHRE DE	AMSE	32.47	2.37	0.23	2.00	33.25
HANOVER SHO	AMSE	45.60	2.21	2.26	2.09	32.51
HASTNGS MFG	AMSE	29.64	1.40	1.10	0.80	19.92
HEALTH-CHEM	AMSE	34.38	1.33	1.52	0.36	16.35
HEALTH-MOR	AMSE	12.30	0.90	0.91	0.25	7.99
HER MAJESTY	AMSE	26.00	2.38	1.23	0.00	18.06
HI-G INC	AMSE	27.91	1.05	0.99	1.22	20.84
HOLLINGR MIN	AMSE	28.40	13.46	14.30	0.00	147.78
HOLLY CORP	AMSE	115.98	3.63	3.25	0.28	44.13
HOME OIL CO	AMSE	103.65	26.55	29.60	0.00	398.19
HSE OF RON	AMSE	30.88	1.00	0.96	1.60	20.66
IMC MAGNTCS	AMSE	21.67	1.12	1.20	0.57	12.96
IMPRL GROUP	AMSE	4891.08	109.44	112.09	96.00	3139.52
INFLGHT SER	AMSE	22.10	0.83	0.23	0.37	25.46
INTL FOSERV	AMSE	257.72	-0.65	-1.72	1.65	77.61
JOHNSN PROD	AMSE	37.66	5.65	5.46	0.42	27.13
KENWIN SHOP	AMSE	13.90	0.50	0.45	0.00	6.57
KETCHUM &CO	AMSE	106.70	0.82	0.72	0.80	25.73
KEWANEE IND	AMSE	246.48	28.55	16.44	2.90	243.68
KEY CO	AMSE	14.11	-0.84	-0.18	0.13	13.88
KING OPTICL	AMSE	8.63	-0.70	0.00	0.34	7.59
KNICKERBOCK	AMSE	26.29	2.62	2.82	0.23	19.39
KOLLMORGEN	AMSE	72.16	2.43	1.00	2.13	47.56
LA MAUR INC	AMSE	27.73	0.57	0.52	0.00	15.42
LA POINTE	AMSE	14.83	0.37	-0.07	0.65	10.33
LABARGE INC	AMSE	73.31	5.22	5.09	0.00	30.80

CLIENTS OF OTHER CPA FIRMS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
LAFAYET RAD	AMSE	91.49	2.12	2.17	1.50	47.04
LEE ENTERPR	AMSE	56.02	7.24	5.37	2.80	70.84
LEHIGH PRES	AMSE	35.78	0.63	0.32	0.00	22.56
LEISURE TEC	AMSE	35.39	-3.31	-3.34	0.40	107.56
LIBRTY FBRC	AMSE	16.99	0.63	0.11	0.00	10.80
LIGTOLR INC	AMSE	63.38	1.21	0.99	1.53	36.35
LILLI ANN	AMSE	13.30	0.48	0.47	0.40	9.84
LILY LYNN	AMSE	56.68	0.54	0.56	0.45	21.34
LK SHOR MIN	AMSE	0.00	1.72	0.00	0.00	19.97
LYNCH CORP	AMSE	11.54	-0.91	0.00	0.00	7.73
M W A CO	AMSE	16.63	0.76	0.64	0.57	12.37
MARINDUQUE	AMSE	0.00	0.00	0.00	0.00	0.00
MARLENE IND	AMSE	99.23	2.57	2.82	4.20	35.28
MARTN PROC	AMSE	94.08	6.81	7.12	1.30	45.25
MASTERS INC	AMSE	68.82	0.14	0.00	1.90	26.28
MCINTOSH CP	AMSE	51.20	3.38	3.11	0.66	29.64
MEDALLN GRP	AMSE	55.04	0.28	1.12	0.83	31.88
MEGC INTL	AMSE	38.09	2.33	1.43	0.85	11.85
MERIDN INDS	AMSE	8.95	-0.44	0.00	0.00	9.72
METROPL GTS	AMSE	10.56	0.00	0.00	0.35	12.55
MILLER H	AMSE	13.99	3.00	2.96	0.03	23.22
MILLER-WOHL	AMSE	68.35	3.67	3.90	1.61	21.28

MOTT'S SUPR	AMSE	119.21	1.11	1.17	1.82	14.61
MOVIE STAR	AMSE	35.14	0.39	0.26	1.90	17.98
MPB CORP	AMSE	45.97	2.83	2.76	1.74	37.92
NAPCO INDS	AMSE	52.50	1.31	0.69	0.00	32.64
NARDA MICRO	AMSE	10.12	0.57	0.33	0.34	7.33
NAT DISTRIB	AMSE	180.78	1.93	2.17	1.30	62.58
NAT PATENT	AMSE	26.60	1.00	0.93	0.60	31.89
NATIONWD HM	AMSE	11.12	1.16	1.17	0.30	10.05
NATL CSS	AMSE	32.34	1.83	1.70	0.61	14.43
NATL PARAGN	AMSE	16.81	0.15	0.11	0.50	13.84
NATL SILVER	AMSE	29.34	0.19	0.13	0.48	19.27
NATL SPINNG	AMSE	70.07	-1.49	-2.08	0.00	42.33
NESTLE-LEMR	AMSE	10.40	-0.28	0.07	0.00	7.01
NEW ENG NUC	AMSE	27.90	2.85	2.72	0.72	22.96
NEWBRY ENGR	AMSE	45.00	1.59	0.17	0.60	20.79
NICHOLS SE	AMSE	157.69	-0.70	-0.86	4.50	36.01
NOLEX CORP	AMSE	36.10	1.18	1.28	0.22	12.23
NUMAC OIL	AMSE	7.98	2.35	1.35	0.00	42.73
OHIO-SEALY	AMSE	29.77	2.22	2.11	0.41	20.26
OLLA INDS	AMSE	18.80	0.19	0.18	0.85	8.98
OOKIEP COPR	AMSE	67.37	14.93	9.33	4.41	50.86
ORIGINALA	AMSE	3.79	0.03	0.01	0.06	1.90
OSULVN CORP	AMSE	29.12	1.41	1.37	0.67	12.17
P & F INDS	AMSE	83.99	1.42	1.51	1.39	47.02
PAC GS PROP	AMSE	29.49	-6.55	0.00	0.00	40.71
PALL CORP	AMSE	48.35	3.56	3.16	1.30	40.12
PANTASOTE	AMSE	86.92	2.23	2.85	2.00	49.51

CLIENTS OF OTHER CPA FIRMS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
PARK CHEM	AMSE	7.87	0.47	0.42	0.09	3.38
PAT FASHION	AMSE	49.72	1.11	1.05	0.96	15.99
PEERLS TUBE	AMSE	16.77	0.50	0.41	0.00	12.75
PEMCOP INC	AMSE	97.25	0.14	0.59	1.85	32.36
PENN TRAFIC	AMSE	159.89	2.92	2.86	2.93	37.41
PENOBSCOT	AMSE	12.40	0.72	0.71	0.65	8.81
PENTRON IND	AMSE	11.53	0.22	0.19	0.41	6.80
PHILPN L D	AMSE	49.59	11.24	0.00	5.21	182.16
PIC N PAY	AMSE	40.89	2.88	2.62	1.35	17.38
PIEDMNT IND	AMSE	27.09	-2.59	-2.17	1.60	14.13
PLY-GEM IND	AMSE	32.79	0.51	0.48	0.73	13.57
PNEUMAT SCL	AMSE	20.97	0.77	0.71	0.00	18.90
PRESLEY COS	AMSE	69.65	-2.62	-2.26	0.20	127.75
PRESTON MIN	AMSE	0.00	12.88	0.00	0.00	129.78
PRIME MOTOR	AMSE	31.24	-3.41	-3.37	1.00	27.71
PROVIDNC GS	AMSE	49.39	-0.17	-0.33	0.00	65.09
PUREPAC LAB	AMSE	13.45	0.47	0.47	0.30	8.54
QUEBECR INC	AMSE	60.31	1.50	1.79	1.56	33.81
RANCHR EXPL	AMSE	17.85	2.39	1.13	0.24	24.71
RANGER OIL	AMSE	3.45	1.18	0.70	0.06	32.78
RB INDS	AMSE	41.78	0.73	0.83	0.79	18.73
REDLAW ENTR	AMSE	5.88	0.21	0.20	0.00	9.54

REGL BELOIT	AMSE	20.48	1.81	1.84	0.59	12.50
RESISTOFLEX	AMSE	34.35	1.86	1.62	0.96	18.83
RICHFRD INC	AMSE	36.60	0.15	0.44	0.96	31.76
ROBINO-LADD	AMSE	39.73	-41.79	-6.40	0.90	140.12
ROYAL PALM	AMSE	26.20	0.23	0.18	0.25	95.42
S M D INDS	AMSE	33.29	0.59	0.41	0.91	17.17
SAN CARLOS	AMSE	9.40	3.17	1.69	0.00	7.27
SAN JUAN	AMSE	8.99	3.39	2.14	0.55	43.82
SCHEIB EARL	AMSE	29.19	0.67	1.06	1.85	14.21
SCHOOL PIC	AMSE	28.07	1.45	1.32	1.30	19.46
SCIENCE MGT	AMSE	15.91	0.31	0.37	0.34	9.77
SEAPORT CP	AMSE	18.57	-0.05	0.04	0.19	12.94
SELAS CP-AM	AMSE	60.73	-1.00	0.08	0.60	27.79
SELIGMN &LT	AMSE	139.42	4.93	4.80	11.00	42.65
SETON CO	AMSE	36.35	0.72	0.51	0.00	21.25
SERVOTRON	AMSE	13.58	-2.95	0.05	0.57	22.18
SHOWBOAT	AMSE	19.49	2.84	2.54	0.76	16.57
SHULMN TRAN	AMSE	72.51	0.42	0.15	1.30	24.21
SILO INC	AMSE	54.20	-0.18	-0.20	0.45	18.88
SIMCO STORE	AMSE	8.07	0.34	0.23	0.35	6.04
SIMKINS IND	AMSE	40.66	2.55	0.92	1.27	37.04
SIMPLEX INC	AMSE	30.18	-1.83	-0.90	0.75	21.32
SITKIN SMLT	AMSE	32.12	0.12	0.06	0.00	18.26
SKY CITY	AMSE	59.39	1.25	1.24	0.00	14.10
SOUND ROYAL	AMSE	36.75	14.44	6.63	0.10	62.97
SONDERLING	AMSE	22.77	1.07	1.05	0.92	27.34
SPECTLY RST	AMSE	42.31	1.33	1.21	3.60	34.31

CLIENTS OF OTHER CPA FIRMS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
SPEIZMN IND	AMSE	22.65	-3.62	-2.21	0.47	22.79
SPENCER COS	AMSE	74.83	-0.96	-0.37	1.00	26.53
SSP INDS	AMSE	28.56	1.41	1.47	0.92	20.33
STANGE CO	AMSE	44.87	0.92	0.74	0.51	22.06
STARDUST	AMSE	11.85	-0.54	-0.09	0.90	9.30
STD CONTAIN	AMSE	31.81	1.40	1.23	0.70	14.96
STD MOTOR	AMSE	78.15	2.98	2.91	1.80	43.18
STEELMET	AMSE	97.27	3.27	3.71	0.37	47.52
STEVCOKNIT	AMSE	40.89	0.98	1.06	0.68	28.33
STRUTHR WLS	AMSE	50.89	1.73	1.82	0.86	38.48
SUMMIT ORG	AMSE	54.92	1.18	0.59	3.13	65.99
SUN CITY	AMSE	48.16	0.47	0.42	0.42	10.53
SUN ELEC	AMSE	69.09	3.75	3.00	2.44	54.84
SUNAIR ELEC	AMSE	10.07	1.18	0.86	0.28	10.19
SUPER FOOD	AMSE	415.15	1.74	1.49	1.15	43.94
SUPERIOR IN	AMSE	28.54	1.00	0.99	0.00	17.72
SUPRONICS	AMSE	3.18	-0.07	0.00	0.05	2.28
SW INDS	AMSE	28.88	2.90	3.02	0.61	23.71
SYNALLOY CP	AMSE	58.53	2.53	2.51	0.69	29.53
TECH OPR	AMSE	100.52	-0.17	-0.77	0.00	45.49
TECH TAPE	AMSE	47.61	0.98	0.78	1.20	26.55
TECHNITROL	AMSE	16.18	0.52	0.51	0.59	8.17

TENN FORG	AMSE	66.36	1.33	0.55	1.25	41.64
TENNEY ENG	AMSE	5.88	0.14	0.09	0.00	2.56
TENSOR CORP	AMSE	5.06	0.01	0.00	0.00	3.06
TIFFANY IND	AMSE	0.00	2.67	0.07	0.48	29.99
TOLCHN INST	AMSE	14.08	-2.86	0.06	0.56	23.02
TOPPS CHEW	AMSE	50.11	1.68	1.57	1.35	23.46
TORIN CORP	AMSE	39.45	0.45	0.43	0.00	32.13
TRANS-LUX	AMSE	9.87	-0.48	-0.02	0.00	16.74
TRI ST MTR	AMSE	62.40	2.09	1.87	0.00	35.69
TRICO INDS	AMSE	25.70	1.55	2.17	0.62	13.38
TUBOS DE AC	AMSE	106.35	4.81	3.18	4.04	130.60
U.N.A. CORP	AMSE	15.78	0.44	0.48	0.11	8.53
UIP CORP	AMSE	37.79	2.38	2.22	0.00	22.27
UNIMAX GRP	AMSE	50.15	0.42	0.73	1.70	43.14
UNION GAS	AMSE	222.47	14.21	14.83	2.08	429.89
UNIV RESOUR	AMSE	6.75	1.75	0.00	0.06	27.21
URS CORP	AMSE	31.18	1.36	1.29	1.00	24.52
UTD ASBESTO	AMSE	8.64	5.53	0.00	0.08	49.49
UTD DOLLAR	AMSE	36.90	-2.37	-0.29	3.25	19.11
UTD FOODS	AMSE	106.50	3.34	2.57	4.66	93.83
UTD PIECE	AMSE	23.30	-1.50	-1.55	0.80	19.83
VALLE STEAK	AMSE	41.95	2.24	2.30	2.35	36.20
VEECO INSTR	AMSE	34.43	1.04	1.48	0.00	29.79
VERIT INDS	AMSE	23.99	0.18	0.18	0.00	5.24
VERNITRON	AMSE	50.34	2.16	1.74	1.60	37.48
VESELY CO	AMSE	16.15	-0.12	-0.11	0.50	6.51
VINTAGE ENT	AMSE	39.65	-2.40	-2.23	0.49	24.78

CLIENTS OF OTHER CPA FIRMS--Continued

COMPANY NAME	EXCHANGE	SALES (MIL.$)	INCOME (MIL.$)	TAXES (MIL.$)	EMPLOYEES (THOUS.)	ASSETS (MIL.$)
VULCAN CORP	AMSE	35.04	-1.04	-0.35	0.00	18.38
WABASH MAG	AMSE	32.93	0.99	0.85	1.07	16.68
WACKENHUT	AMSE	102.44	2.57	2.56	12.00	47.52
WAINOCO OIL	AMSE	3.70	0.74	0.09	0.00	21.14
WALLACE SAM	AMSE	157.65	1.86	1.87	2.64	46.90
WEST CHEM	AMSE	66.30	1.72	1.03	1.70	30.22
WESTBRY FSH	AMSE	8.59	0.02	0.00	0.45	1.67
WESTST PETE	AMSE	13.03	4.15	2.75	0.07	29.40
WHIPNY PAPR	AMSE	65.53	1.22	0.97	0.76	51.93
WHITKR CABL	AMSE	52.10	1.17	0.92	2.43	32.36
WINKLMN STR	AMSE	68.12	2.10	2.20	3.00	26.97
WINSTN MILL	AMSE	69.30	0.78	0.43	1.10	35.32
WRIGHT HARG	AMSE	0.00	0.86	0.00	0.00	8.78
WSTN DECALT	AMSE	14.27	3.48	1.93	0.10	60.62
WTC AIRFRGT	AMSE	79.51	0.01	-0.22	0.00	20.77
WYLE LABS	AMSE	131.09	2.96	2.62	2.42	70.41
YOO-HO CHOC	AMSE	16.76	0.49	0.64	0.14	7.41

ATTACHMENT 2--LIST OF ORGANIZATIONS OCCURRING ON MORE THAN ONE CLIENT LIST

ORGANIZATIONS LISTED IN TWO CLIENT GROUPS

Organization	Exchange	List
APCO Oil Corporation	NYSE	PMM, AA
Budget Industries, Inc.	NYSE	PMM, AA
CCI Corporation	NYSE	PMM, CL
Chris-Craft Industries, Inc.	NYSE	HS, AA
ConAgra, Incorporated	NYSE	PMM, CL
DPF, Inc.	NYSE	PMM, AY
Dial Financial Corporation	NYSE	PMM
	AMSE	HS
Elgin National Industries, Inc.	NYSE	PW, TR
General Cable Corporation	NYSE	PMM, AY
Grolier, Inc.	NYSE	PMM, AA
Walter Kidde & Co., Inc.	NYSE	PW, AA
Minnesota Mining & Manufacturing Co.	NYSE	HS, CL
Mobil Home Industries, Inc.	NYSE	PW, PMM
Avondale Mills	AMSE	PMM, AY
Aydin Corporation	AMSE	PW, HS
Computer Investors Group, Inc.	AMSE	PMM, AY
Eastern Co. (The)	AMSE	EE, CL
Glasrock Products, Inc.	AMSE	PW, AA
Gruen Industries, Inc.	AMSE	CL, TR
Landmark Land Co., Inc.	AMSE	PW, PMM
Permaneer Corporation	AMSE	PW, HS
Rockwood National Corporation	AMSE	PMM, CL
Splentex, Inc.	AMSE	AA, CL
Sterling Electronics Corp.	AMSE	PMM, AA

ATTACHMENT 3--LIST OF ORGANIZATIONS WITH NO FINANCIAL DATA

ORGANIZATIONS WITH NO FINANCIAL DATA

Price Waterhouse & Co.

Name of Corporation	City	State	Exchange
Advance Investors	New York	New York	NYSE
Builders Investment Group	Valley Forge	Pennsylvania	NYSE
Bunker Hill Income Securities, Inc.	Los Angeles	California	NYSE
Chase Convertible Fund of Boston, Inc.	Boston	Massachusetts	NYSE
Chicago & Easter Illinois Railroad Company	Chicago	Illinois	NYSE
CNA-Larwin Investment Co	New York	New York	NYSE
Continental Mortgage Investors	Boston	Massachusetts	NYSE
Drexel Bond-Debenture Trading Fund	Philadelphia	Pennsylvania	NYSE
Gemini Fund, Inc.	Valley Forge	Pennsylvania	NYSE
Income & Capital Shares	Boston	Massachusetts	NYSE
International Holdings	New York	New York	NYSE
International Nickel Company of Canada, LTD	New York	New York	NYSE
Niagara Share	Buffalo	New York	NYSE
Pacific American Income Shares, Inc	Pasadena	California	NYSE
Standard & Poor's/Inter-capital Income Securities	New York	New York	NYSE
State Mutual Securities	Worcester	Massachusetts	NYSE
Tandycrafts Inc.	Fort Worth	Texas	NYSE
The Canada Southern Railway Co.	Philadelphia	Pennsylvania	NYSE
The Japan Fund	New York	New York	NYSE
United States & Foreign Securities	New York	New York	NYSE
Diebold Venture Capital	New York	New York	AMSE
Drexel Utility Shares, Inc.	Philadelphia	Pennsylvania	AMSE
Fidelco Growth Investors	Rosemont	Pennsylvania	AMSE
Hanover Square Realty Investors	New York	New York	AMSE
Herff Jones Company (Carnation Co.)	Indianapolis	Indiana	AMSE

ORGANIZATIONS WITH NO FINANCIAL DATA

Price Waterhouse & Co. (continued)

Name of Corporation	City	State	Exchange
New Mexico & Arizona Land Company	Phoenix	Arizonia	AMSE
Pittsburg & West Virginia Railroad	Pittsburgh	Pennsylvania	AMSE
Rowland Products Inc.	Kennsington	Connecticut	AMSE
Washington Real Estate Investment Trust Company	Bethesda	Maryland	AMSE
Imperial Chemical Industries, Inc.	London	United Kingdom	AMSE

ORGANIZATIONS WITH NO FINANCIAL DATA

Haskins & Sells

Name of Corporation	City	State	Exchange
Hatteras Income Securities, Inc.	Charlotte	North Carolina	NYSE
Tri-Continental	New York	New York	NYSE
Associated Mortgage Investors	Coral Gables	Florida	AMSE
Braniff Airways, Inc.	Dallas	Texas	AMSE
Hospital Mortgage Group	North Miami	Florida	AMSE
National Power & Light	Raleigh	North Carolina	AMSE
Overseas Securities Co., Inc.	New York	New York	AMSE
Southland Royalty Co.	Fort Worth	Texas	AMSE
Standard Shares, Inc.	New York	New York	AMSE
United Companies Financial	Baton Rouge	Louisiana	AMSE

ORGANIZATIONS WITH NO FINANCIAL DATA

Peat, Marwick, Mitchell & Co.

Name of Corporation	City	State	Exchange
American Century Mortgage Investors	Jacksonville	Florida	NYSE
C.I. Realty Investors	Boston	Massachusetts	NYSE
Cameron-Brown Investment Group	Raleigh	North Carolina	NYSE
CNA Financial Corporation	Chicago	Illinois	NYSE
Colwell Mortgage Trust	Los Angeles	California	NYSE
Current Income Shares, Inc.			
Far West Financial Corporation	Newport Beach	California	NYSE
Fidelity Financial Corporation	San Francisco	California	NYSE
Fidelity Mortgage Investors	Boston	Massachusetts	NYSE
First National City Corporation	New York	New York	NYSE
GAC Corporation	Miami	Florida	NYSE
Gulf Mortgage and Realty Investments	Boston	Massachusetts	NYSE
Londontown Manufacturing Co.	Baltimore	Maryland	NYSE
Midland Mortgage Investors Trust	Oklahoma City	Oklahoma	NYSE
National Aviation Corporation	New York	New York	NYSE
Republic Financial Services, Inc.	Dallas	Texas	NYSE
Texas Pacific Land Trust	New York	New York	NYSE
The Umet Trust	Beverly Hills	California	NYSE
Uslife Income Fund, Inc.	New York	New York	NYSE
The Wheeling and Lake Erie Railway Co.	Roanoke	Virginia	NYSE
Affiliated Capital Corporation	Houston	Texas	AMSE
Berg Enterprises Realty Group	New York	New York	AMSE
Central Securities Corporation	New York	New York	AMSE
ICM Corporation	Kansas City	Missouri	AMSE
ICM Reality	New York	New York	AMSE
Investors Realty Trust	Nashville	Tennessee	AMSE
NJB Prime Investors	Clifton	New Jersey	AMSE
Prudent Real Estate Trust	New York	New York	AMSE
S-G Securities Inc.	Boston	Massachusetts	AMSE

ORGANIZATIONS WITH NO FINANCIAL DATA

Ernst & Ernst

Name of Corporation	City	State	Exchange
American General Bond Fund	Baltimore	Maryland	NYSE
American General Convertible Sec.	Baltimore	Maryland	NYSE
Great Northern Iron Ore Properties	Saint Paul	Minnesota	NYSE
John Hancock Income Securities	Boston	Massachusetts	NYSE
John Hancock Investors Inc.	Boston	Massachusetts	NYSE
Lincoln National Direct Placement Fund	Chicago	Illinois	NYSE
Lomas & Nettleton Mortgage Investors	Dallas	Texas	NYSE
Montgomery Street Income Securities	San Francisco	California	NYSE
National Mortgage Fund	Rocky River	Ohio	NYSE
U.S. Realty Investments	Cleveland	Ohio	NYSE
First of Denver Mortgage Investors	Denver	Colorado	AMSE
Southeastern Capital Corporation	Atlanta	Georgia	AMSE

ORGANIZATIONS WITH NO FINANCIAL DATA

Arthur Young & Company

Name of Corporation	City	State	Exchange
Cornwall Equities, Ltd	New York	New York	NYSE
INA Investment Securities, Inc.	Philadelphia	Pennsylvania	NYSE
PNB Mortgage & Realty Investors	Melrose Park	Pennsylvania	NYSE
United Corporation, The	New York	New York	NYSE
First Realty Investment Corporation	Miami Beach	Florida	AMSE
Mission Investment Trust	San Diego	California	AMSE
National Bellas Hess, Inc.	North Kansas City	Missouri	AMSE
PNB Mortgage and Realty Investors	Melrose Park	Pennsylvania	AMSE
Property Capital Trust	Boston	Massachusetts	AMSE
Realty Income Trust	Providence	Rhode Island	AMSE
United States Bancorp Realty & Mortgage Trust	Portland	Oregon	AMSE

ORGANIZATIONS WITH NO FINANCIAL DATA

Arthur Andersen & Co.

Name of Corporation	City	State	Exchange
Alabama Power Company	Birmingham	Alabama	NYSE
Continental Illinois Realty	Los Angeles	California	NYSE
Excelsior Income Shares	New York	New York	NYSE
First Union Real Estate Equity & Mortgage, Inv.	Cleveland	Ohio	NYSE
First Wisconsin Mortgage Trust	Milwaukee	Wisconsin	NYSE
General Telephone Company of Florida	Tampa	Florida	NYSE
Georgia Power Company	Atlanta	Georgia	NYSE
Mutual of Omaha Interest Shares	Omaha	Nebraska	NYSE
Republic Mortgage Investors	Coral Gables	Florida	NYSE
American Fletcher Mortgage Investors	Boston	Massachusetts	AMSE
Argus Inc.	Ann Arbor	Michigan	AMSE
Bayrock Utility Securities	New York	New York	AMSE
Castlewood International Corporation	Miami	Florida	AMSE
Central Power & Light Co. (Texas)	Corpus Christi	Texas	AMSE
Cousins Mortgage & Equity Investments	Atlanta	Georgia	AMSE
First Virginia Mortgage & R.E.I.T.	Falls Church	Virginia	AMSE
(The) Hotel Investors	Kensington	Maryland	AMSE
Pennsylvania Real Estate Investment Trust	Wyncote	Pennsylvania	AMSE
Real Estate Investment Trust of Amer.	Boston	Massachusetts	AMSE
Realty Refund Trust	Cleveland	Ohio	AMSE
Reit Income Fund, Inc.	Boston	Massachusetts	AMSE
Republic Mortgage Investors	Coral Gables	Florida	AMSE
Security Mortgage Investors	Boston	Massachusetts	AMSE
Stellar Industries, Inc.	Buena Park	California	AMSE

ORGANIZATIONS WITH NO FINANCIAL DATA

Coopers and Lybrand

Name of Corporation	City	State	Exchange
Adams Express Company	New York	New York	NYSE
Atico Mortgage Investors	Miami	Florida	NYSE
Barber Oil Corporation	New York	New York	NYSE
Barnett Mortgage Trust	Jacksonville	Florida	NYSE
CNA-Larwin Investment Company	New York	New York	NYSE
Capital Mortgage Investments	Chevy Chase	Maryland	NYSE
Carriers & General Corp	New York	New York	NYSE
Colonial Penn Group, Inc.	Philadelphia	Pennsylvania	NYSE
Fidelity Mortgage Investors	Jacksonville	Florida	NYSE
Hemisphere Fund, Inc.	New York	New York	NYSE
Jersey Central Power & Light Co.	Morristown	New Jersey	NYSE
Madison Fund, Inc.	Wilmington	Delaware	NYSE
Martin Marietta Aluminum, Inc.	Washington	District of Columbia	NYSE
Mass. Mutual Corporate Investors, Inc.	Springfield	Massachusetts	NYSE
Mass. Mutual Income Investors, Inc.	Springfield	Massachusetts	NYSE
Metropolitan Edison Company	Reading	Pennsylvania	NYSE
Mission Equities Corporation	Los Angeles	California	NYSE
Petroleum Corporation of America	New York	New York	NYSE
Scudder Duo-Vest, Inc.	New York	New York	NYSE
American Realty Trust	Arlington	Virginia	AMSE
Baldwin Securities Corporation	New York	New York	AMSE
Bancroft Convertible Fund, Inc.	New York	New York	AMSE
First Connecticut Small Business	Bridgeport	Connecticut	AMSE
Fresnillo Company	New York	New York	AMSE
Greit Realty Trust	Drexel Hill	Pennsylvania	AMSE
Investors Funding Corp	New York	New York	AMSE

ORGANIZATIONS WITH NO FINANCIAL DATA

Touche Ross & Co.

Name of Corporation	City	State	Exchange
Citizens Mortgage Investment	Detroit	Michigan	NYSE
IDS Properties, Inc.	Minneapolis	Minnesota	NYSE
Justice Mortgage Investor	Dallas	Texas	NYSE
Larwin Multihousing Corporation	Beverly Hills	California	NYSE
Michigan Wheel Corporation	Grand Rapids	Michigan	NYSE
North Carolina Utility	Atlanta	Georgia	NYSE
St. Paul Securities, Inc.	St. Paul	Minnesota	NYSE
Teckla, Inc.	Amarillo	Texas	NYSE
TSC Industries	Chicago	Illinois	NYSE
Vestaur Securities, Inc.	Philadelphia	Pennsylvania	NYSE
Westland Capital Corporation	Minneapolis	Minnesota	NYSE
Heitman Mortgage Investors	Chicago	Illinois	AMSE
Suncraft Division Aberdeen, Mfg.	Fresno	California	AMSE
Philadelphia Mortgage Trust	Philadelphia	Pennsylvania	AMSE

APPENDIX C—"BIG EIGHT" FIRMS' TESTIMONY AND PRESENTATIONS BEFORE CONGRESS, STATE LEGISLATURES AND REGULATORY COMMISSIONS

ABRAHAM RIBICOFF, CONN., CHAIRMAN

JOHN L. MC CLELLAN, ARK.
HENRY M. JACKSON, WASH.
EDMUND S. MUSKIE, MAINE
LEE METCALF, MONT.
JAMES B. ALLEN, ALA.
LAWTON CHILES, FLA.
SAM NUNN, GA.
JOHN GLENN, OHIO

CHARLES H. PERCY, ILL.
JACOB K. JAVITS, N.Y.
WILLIAM V. ROTH, JR., DEL.
BILL BROCK, TENN.
LOWELL P. WEICKER, JR., CONN.

RICHARD A. WEGMAN
CHIEF COUNSEL AND STAFF DIRECTOR

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

SUBCOMMITTEE:
LEE METCALF, MONT., CHAIRMAN

JOHN L. MC CLELLAN, ARK.
EDMUND S. MUSKIE, MAINE
SAM NUNN, GA.
JOHN GLENN, OHIO

BILL BROCK, TENN.
CHARLES H. PERCY, ILL.
LOWELL P. WEICKER, JR., CONN.

VIC REINEMER, STAFF DIRECTOR
E. WINSLOW TURNER, CHIEF COUNSEL
161 RUSSELL BUILDING

(202) 224-1474

8 April, 1976

Mr. Harvey Kapnick
Managing Partner
Arthur Andersen & Co.
69 West Washington Street
Chicago, Illinois 60602

(Staff note: The same letter was sent to other "Big Eight" firms.)

Dear Mr. Kapnick:

The response of your firm to this subcommittee's accounting questionnaire of 19 December, 1975 will be useful in helping us evaluate the relationship between the accounting profession and Federal agencies.

My attention has recently been drawn to several instances where major accounting firms have testified or made presentations before Congress, state legislatures, and Federal and state regulatory commissions. The firms sometimes represent clients and other times represent themselves.

In order that we may have a better understanding of the activities and services performed by accounting firms, please provide this subcommittee with copies of any testimony or presentations which your firm has given to Congress, a state legislature, or a Federal or state regulatory commission since 1 January, 1975. If copies are not available, please furnish the subcommittee with a brief description of each presentation along with such particulars as may enable us to obtain copies from the official source.

Your help in providing the subcommittee with this information by 1 May, 1976 will greatly expedite our study of Federal accounting procedures relating to the accounting profession.

Thank you for your cooperation.

Very truly yours,

Lee Metcalf

ARTHUR ANDERSEN & CO.

G. E. STANTON
VICE CHAIRMAN-ADMINISTRATION

69 WEST WASHINGTON STREET
CHICAGO, ILLINOIS 60602

April 30, 1976

Honorable Lee Metcalf, Chairman
Subcommittee on Reports,
Accounting, and Management
Committee on Government Operations
United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

In response to your letter request of April 8, 1976, we submit herewith data as to testimony and presentations by representatives of our firm before the Congress and before state legislatures for the period January 1, 1975, to April 15, 1976. These data include copies of such testimony and presentations (where readily available) and are categorized in the accompanying list according to the basis on which such testimony or presentations were made:

A. Requested by the official body;

B. Performed as a professional client service;

C. Performed on behalf of a professional, civic, community, or trade organization of which our representative is an officer or member;

D. Performed as a public service at the invitation of a professional, civic, community, or trade organization; or,

E. Performed as a public service on the initiative of the firm.

We are in the process of accumulating from each of our United States offices data concerning any public testimony or presentations made by representatives of our firm for the period January 1, 1975, to April 15, 1976, to Federal and state regulatory commissions. We believe that these appearances were numerous; we will send a list of such events to the Subcommittee as soon as it can be assembled. The listing to be sent to you with respect to testimony and presentations by representatives of our firm before Federal and state regulatory commissions will sufficiently identify the proceedings to enable you to request copies of these data from the regulatory commissions should you desire them.

We were informed by a representative of the Subcommittee that we need not include data concerning private meetings or discussions with the Congress or state legislatures or with Federal or state regulatory commissions with respect to client engagements or the firm's internal affairs. We have also not included our proposals to provide professional services at the invitation of legislative bodies or regulatory commissions.

It should be understood that after-the-fact corrections to the record may have been made in some cases which may not be reflected in the enclosed data. Also, some testimony and presentations were extemporaneous and no record was made by the official body.

To comply with the Subcommittee request for the data enclosed herewith, it has been necessary to make direct inquiry to our more than two thousand partners and managers in our United States offices. While we believe that the enclosed data are complete with respect to testimony and presentations by representatives of our firm to the Congress and state legislatures, some additional data may have to be submitted later since all of our partners and managers have not been immediately available to respond to our request for such information.

In any testimony or presentation before any official body, we do not appear as an advocate of the interests of any client, but rather in support of the principles and policies that our firm believes to be sound. Our testimony or presentation at the request of any company or group is not indicative that we are their representatives, but rather that they respect our independent views and therefore ask us to present them.

Please contact Mr. Harvey Kapnick, Chairman and Chief Executive of our firm, or Mr. Charles A. Bowsher, a partner in our Washington, D.C., office who is the Director of our Federal Government Liaison Group, or me, if we can be of further assistance in discussing these matters or providing additional information.

Very truly yours,

S. D. Thornton

Enclosures

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

A. REQUESTED BY THE OFFICIAL BODY

1. Date — February 24, 1976

Submitted to: United States Senate - Subcommittee on Securities of the Committee on Banking, Housing and Urban Affairs

Initiated by: The Subcommittee on Securities

Arthur Andersen & Co. Representative:

Harvey Kapnick, Partner - Chicago Office
Chairman of Arthur Andersen & Co.

Subject Matter: Presentation of views on the accounting and financial reporting of state and local government entities and their systems and controls, particularly as these matters relate to the issuance of securities by those entities. (Public Hearing on S.2969, the Municipal Securities Full Disclosure Act of 1976)

Supporting Material: Copy enclosed (A-1)

2. Date: March 8, 1976

Submitted to: The State of Colorado - Joint Budget Committee of the State Legislature

Initiated by: The Governor of Colorado and the Chairman of the Joint Budget Committee

Arthur Andersen & Co. Representative:

Thomas M. Hallin, Partner - Denver Office

Subject Matter: Mr. Hallin appeared as the Chairman of a volunteer committee established at the request of the Executive Director of the Department of Social Services and participated in a discussion of the administration of the State Department of Social Services.

Supporting Material: No formal testimony, statement or presentation was submitted

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

A. REQUESTED BY THE OFFICIAL BODY
(Continued)

3. Date: April 7, 1976

Submitted to: United States House of Representatives - Subcommittee on the Panama Canal of the Committee on Merchant Marine and Fisheries

Initiated by: Committee on Merchant Marine and Fisheries

Arthur Andersen & Co. Representatives:

Leonard J. Kujawa, Partner - Chicago Office
Donald V. Kane, Partner - Washington, D.C. Office

Subject Matter: Financial and accounting matters regarding the Panama Canal Company and H.R. 12641

Supporting Material: Copy enclosed (A-3)

4. Date: April 7, 1976

Submitted to: United States House of Representatives - Subcommittee on Energy and Power of the Committee on Interstate and Foreign Commerce

Initiated by: Chairman of Subcommittee on Energy and Power

Arthur Andersen & Co. Representative:

Richard W. Walker, Partner - Chicago Office

Subject Matter: The desirability of including construction work in progress in rate base

Supporting Material: Copy enclosed (A-4)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

B. PERFORMED AS A PROFESSIONAL CLIENT SERVICE

1. Date: March 26, 1975

   Submitted to: Alabama House of Representatives - Joint Meeting of the Judiciary and Ways and Means Committees

   Initiated by: Alabama Power Company (a client of the firm) - at the request of the Committees

   Arthur Andersen & Co. Representative:

   Richard W. Walker, Partner - Chicago Office

   Subject Matter: Various utility matters including proper test period, propriety of fuel adjustment clauses, appropriate suspension period, etc.

   Supporting Material: No formal testimony, statement or presentation was submitted. Comments were extemporaneous and transcript was not made.

2. Date: July 22, 1975

   Submitted to: Minnesota State Legislature - Special Subcommittee for the review of Hennepin County Government

   Initiated by: Hennepin County (a client of the firm)

   Arthur Andersen & Co. Representative:

   John C. Love, Partner - Minneapolis Office

   Subject Matter: Our audit approach to Hennepin County's financial affairs

   Supporting Material: Mr. Love responded to questions. No formal testimony, statement or presentation was submitted.

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

B. PERFORMED AS A PROFESSIONAL CLIENT SERVICE
(Continued)

3. Date: September 17, 1975

Submitted to: Minnesota State Legislature - Special Subcommittee for the review of Hennepin County Government

Initiated by: Hennepin County (a client of the firm)

Arthur Andersen & Co. Representative:

Jay H. Wein, Partner - Minneapolis Office

Subject Matter: Our audit approach to Hennepin County's financial affairs

Supporting Materials: Copy enclosed (B-3)

4. Date: February 15, 1976

Submitted to: Florida House of Representatives - Select Subcommittee from Committee on Growth and Energy

Initiated by: Four Florida electric utilities (clients of the firm) - at the request of the Chairman of the Select Subcommittee

Arthur Andersen & Co. Representative:

Richard W. Walker, Partner - Chicago Office

Subject Matter: Workshop discussion on full vs. partial "normalization" of income taxes

Supporting Material: Comments were extemporaneous; slides were used in discussion

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

B. PERFORMED AS A PROFESSIONAL CLIENT SERVICE (Continued)

5. Date: March 18, 1976

Submitted to: Florida House of Representatives - Committee on Growth and Energy and Committee on Finance and Taxation

Initiated by: Four Florida electric utilities (clients of the firm) - at the request of the Chairman of the joint meeting

Arthur Andersen & Co. Representative:

Richard W. Walker, Partner - Chicago Office

Subject Matter: Full vs. partial "normalization" of income taxes

Supporting Material: Copy enclosed (B-5)

6. Date: March 24, 1976

Submitted to: United States Senate - Committee on Commerce and the Committee on Interior and Insular Affairs

Initiated by: Alaskan Arctic Gas Pipeline Company (a client of the firm)

Arthur Andersen & Co. Representative:

John Jeter, Partner - Omaha Office

Subject Matter: Mr. Jeter assisted in the development of certain schedules included as a part of the testimony given by Mr. William W. Brackett, Vice Chairman, Alaskan Arctic Gas Pipeline Company. This testimony was in response to a questionnaire sent by the Senate Committees and presented at public hearings held to determine the most effective and efficient manner for transporting Alaskan gas resources.

Supporting Material: None submitted. Mr. Jeter appeared before the Committees with Mr. Brackett but made no remarks.

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

B. PERFORMED AS A PROFESSIONAL CLIENT SERVICE (Continued)

7. Date: April 5, 1976

Submitted to: Illinois Legislative Audit Commission (represents both the House and Senate of the State of Illinois)

Initiated by: State of Illinois Auditor General (a client of the firm)

Arthur Andersen & Co. Representative:

Byron F. Johnson, Partner - Chicago Office

Subject Matter: Review of our audit reports on (1) non-fiscal responsibilities of the State Comptroller for the period July 1, 1972, through June 30, 1974, (2) fiscal responsibilities of the State Comptroller for the period July 1, 1974, through March 31, 1975, and (3) fiscal responsibilities of the State Comptroller for the fiscal year ended June 30, 1975.

Supporting Material: No formal testimony, statement or presentation was submitted. Responded to questions only.

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

C. PERFORMED ON BEHALF OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION OF WHICH OUR REPRESENTATIVE IS AN OFFICER OR MEMBER

1. Date: February 19, 1975

   Submitted to: Massachusetts General Court

   On Behalf Of: Greater Boston Chamber of Commerce

   Arthur Andersen & Co. Representative:

   Thomas A. Sampson, Partner - Boston Office (Vice President, Greater Boston Chamber of Commerce)

   Subject Matter: The Initiative Petition to Create a Massachusetts Public Power Authority

   Supporting Material: Copy enclosed (C-1)

2. Date: February 24, 1975

   Submitted to: The United States Senate - Select Committee on Small Business

   On Behalf Of: The Denver Chamber of Commerce - Small Business Council

   Arthur Andersen & Co. Representative:

   Lawrence A. Sluss, Partner - Denver Office (Chairman, Small Business Council of the Denver Chamber of Commerce)

   Subject Matter: Problems confronting small business

   Supporting Material: Copy enclosed (C-2)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

C. PERFORMED ON BEHALF OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION OF WHICH OUR REPRESENTATIVE IS AN OFFICER OR MEMBER (Continued)

3. Date: March 20, 1975

Submitted to: The State of Oregon - House Revenue Committee

On Behalf Of: The United Way of the Columbia-Willamette

Arthur Andersen & Co. Representative:

P. R. Bogue, Partner - Portland Office (President, United Way of the Columbia-Willamette)

Subject Matter: Proposed legislation to eliminate property tax exemption for charitable organizations

Supporting Material: Copy enclosed (C-3)

4. Date: April 4, 1975

Submitted to: The United States House of Representatives - Subcommittee on Equal Opportunities of the House, Education and Labor Committee in Atlanta, Georgia

On Behalf Of: The Atlanta Chamber of Commerce

Arthur Andersen & Co. Representative:

Samuel Hudgins, Partner - Atlanta Office (Treasurer of the Atlanta Chamber of Commerce) and member of the Executive Committee and Board of Directors)

Subject Matter: Equal Opportunity and Full Employment Act of 1976 (H.R. 50)

Supporting Material: Copy enclosed (C-4)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

C. PERFORMED ON BEHALF OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION OF WHICH OUR REPRESENTATIVE IS AN OFFICER OR MEMBER (Continued)

5. Date: April 30, 1975

Submitted to: The State of Michigan - Taxation Committee of the Michigan State House of Representatives

On Behalf Of: The Grand Rapids Area Chamber of Commerce - Task Force on State Taxation

Arthur Andersen & Co. Representative:

John W. Winter, Jr., Partner - Grand Rapids Office (Chairman of Task Force on State Taxation - Grand Rapids Chamber of Commerce)

Subject Matter: State House Bill 4640 (Proposed Business Privilege Tax)

Supporting Material: Copy enclosed (C-5)

6. Date: July 15, 1975

Submitted to: The United States House of Representatives - Ways and Means Committee

On Behalf Of: The American Institute of Certified Public Accountants (hereinafter referred to as "AICPA") - Tax Division

Arthur Andersen & Co. Representative:

W. C. Penick, Partner - Washington, D.C. Office (Chairman, AICPA Tax Division)

Subject Matter: A wide range of major tax reform subjects

Supporting Material: Not readily available, in process of assembly for later submission

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

C. PERFORMED ON BEHALF OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION OF WHICH OUR REPRESENTATIVE IS AN OFFICER OR MEMBER (Continued)

7. Date: July 25, 1975

Submitted to: The United States House of Representatives - Ways and Means Committee, Subcommittee on Oversight

On Behalf Of: AICPA-Tax Division

Arthur Andersen & Co. Representative:

W. C. Penick, Partner - Washington, D.C. Office (Chairman, AICPA Tax Division)

Subject Matter: Regulation of tax return preparers

Supporting Material: Not readily available, in process of assembly for later submission

8. Date: September 22, 1975

Submitted to: The Massachusetts General Court - Joint Committee on Taxation

On Behalf Of: Greater Boston Chamber of Commerce

Arthur Andersen & Co. Representative:

Thomas A. Sampson, Partner - Boston Office (President, Greater Boston Chamber of Commerce)

Subject Matter: A tax proposal for the Commonwealth

Supporting Material: Copy enclosed (C-8)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

C. PERFORMED ON BEHALF OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION OF WHICH OUR REPRESENTATIVE IS AN OFFICER OR MEMBER (Continued)

9. Date: November 6, 1975

Submitted to: The United States Senate - Committee on Finance, Subcommittee on Administration of the Internal Revenue Code

On Behalf Of: AICPA-Federal Tax Division

Arthur Andersen & Co. Representative:

W. C. Penick, Partner - Washington, D.C. Office (Chairman, AICPA Tax Division)

Subject Matter: Disclosure of Private Rulings

Supporting Material: Not readily available, in process of assembly for later submission

10. Date: November 13, 1975

Submitted to: The United States Senate - Select Committee on Small Business

On Behalf Of: AICPA-Federal Tax Division

Arthur Andersen & Co. Representative:

W. C. Penick, Partner - Washington, D.C. Office (Chairman, AICPA Tax Division)

Subject Matter: Tax reform for small business

Supporting Material: Not readily available, in process of assembly for later submission

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

C. PERFORMED ON BEHALF OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION OF WHICH OUR REPRESENTATIVE IS AN OFFICER OR MEMBER (Continued)

11. Date: February, 1976

Submitted to: The Massachusetts General Court

On Behalf Of: Greater Boston Chamber of Commerce

Arthur Andersen & Co. Representative:

Thomas A. Sampson, Partner - Boston Office (President, Greater Boston Chamber of Commerce)

Subject Matter: Four Energy Priorities for Economic Recovery

Supporting Material: Mr. Sampson did not make a personal appearance. A booklet published by the Greater Boston Chamber of Commerce was submitted by him. Copy enclosed (C-11)

12. Date: March 15, 1976

Submitted to: The United States House of Representatives - Ways and Means Committee

On Behalf Of: AICPA-Federal Tax Division

Arthur Andersen & Co. Representative:

W. C. Penick, Partner - Washington, D.C. Office (Chairman, AICPA Tax Division)

Subject Matter: Estate and Gift Tax Reform

Supporting Material: Not readily available, in process of assembly for later submission

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

C. PERFORMED ON BEHALF OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION OF WHICH OUR REPRESENTATIVE IS AN OFFICER OR MEMBER (Continued)

13. Date: March 18, 1976

Submitted to: The United States Senate - Committee on Finance

On Behalf Of: AICPA-Federal Tax Division

Arthur Andersen & Co. Representative:

W. C. Penick, Partner - Washington, D.C. Office (Chairman, AICPA Tax Division)

Subject Matter: Various tax reform subjects

Supporting Material: Not readily available, in process of assembly for later submission

14. Date: March 23, 1976

Submitted to: The Massachusetts General Court

On Behalf Of: The Greater Boston Chamber of Commerce

Arthur Andersen & Co. Representative:

Thomas A. Sampson, Partner - Boston Office (President, Greater Boston Chamber of Commerce)

Subject Matter: Some basic facts about the Lifeline and Flat Rates Debate

Supporting Material: Mr. Sampson did not make a personal appearance. A booklet published by the Greater Boston Chamber of Commerce was submitted by him. Copy enclosed (C-14)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

C. PERFORMED ON BEHALF OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION OF WHICH OUR REPRESENTATIVE IS AN OFFICER OR MEMBER (Continued)

15. Date: April, 1976

Submitted to: The Massachusetts General Court - Committee on Taxation

On Behalf Of: The Greater Boston Chamber of Commerce

Arthur Andersen & Co. Representative:

Gerald J. Holtz, Partner - Boston Office (Chairman of the Subcommittee on Taxation of the Greater Boston Chamber of Commerce)

Subject Matter: Regarding S.1081, H.1431 and H.1841, proposed legislation to repeal the so called "flat rate" and impose a graduated state income tax

Supporting Material: Copy enclosed (C-15)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

D. PERFORMED AS A PUBLIC SERVICE AT THE INVITATION OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION

1. Date: June, 1975

   Submitted to: The General Assembly of Pennsylvania

   At the Invitation of: The Smaller Manufacturers Council of Pittsburgh

   Arthur Andersen & Co. Representative:

   Frank P. DeMarco, Partner - Pittsburgh Office

   Subject Matter: Concerning a proposal for adoption of an alternative system of depreciation for income tax purposes.

   Supporting Material: Copy enclosed (D-1)

2. Date: July 23, 1975

   Submitted to: The General Assembly of Pennsylvania

   At the Invitation of: The Smaller Manufacturers Council of Pittsburgh, Pennsylvania

   Arthur Andersen & Co. Representative:

   Michael M. Scharf, Manager - Pittsburgh Office

   Subject Matter: Tax Bills (Senate Bills 990 and 989)

   Supporting Material: Copy enclosed (D-2)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

D. PERFORMED AS A PUBLIC SERVICE AT THE INVITATION OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION (Continued)

3. Date: September 24, 1975

Submitted to: The United States Senate - Joint Meeting of the Select Committee on Small Business and the Committee on Finance

At the Invitation of: The Smaller Manufacturers Council, Pittsburgh, Pennsylvania

Arthur Andersen & Co. Representative:

W. D. Barth, Partner - Chicago Office

Subject Matter: Small Business Tax Reform

Supporting Material: Copy enclosed (D-3)

4. Date: March 16, 1976

Submitted to: The United States House of Representatives - Ways and Means Committee

At the Invitation of: The Coalition for the Public Good (a Washington, D.C. based organization representing publicly supported charities)

Arthur Andersen & Co. Representative:

Donald Tollefson, Partner - Washington, D.C. Office

Subject Matter: Estate and Gift Tax Reform

Supporting Material: Copy enclosed (D-4)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

D. PERFORMED AS A PUBLIC SERVICE AT THE INVITATION OF A PROFESSIONAL, CIVIC, COMMUNITY, OR TRADE ORGANIZATION (Continued)

5. Date: April 8, 1976

Submitted to: The United States Senate - Committee on Finance

At the Initiation of: Coalition for the Public Good (a Washington, D.C. based organization representing publicly supported charities)

Arthur Andersen & Co. Representative:

Donald Tollefson, Partner - Washington, D.C. Office

Subject Matter: Estate and Gift Tax Reform

Supporting Material: Copy enclosed (D-5)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

E. PERFORMED AS A PUBLIC SERVICE ON THE INITIATIVE OF THE FIRM

1. Date: March 20, 1975

   Submitted to: The State of Nevada - Special Committee created by A.B. 275 investigating utilities regulation, rates and financing requirements

   Initiated by: Arthur Andersen & Co.

   Arthur Andersen & Co. Representative:

   P. Gregory Conlon, Partner - San Francisco Office

   Subject Matter: Sound Accounting and Rate Making for Nevada Utility Companies

   Supporting Material: Copy enclosed (E-1)

2. Date: June 11, 1975

   Submitted to: The State of Illinois - Senate Labor and Commerce Committee

   Initiated by: Arthur Andersen & Co.

   Arthur Andersen & Co. Representative:

   Barrett Crawford, Partner - Chicago Office Firm Controller

   Subject Matter: Hearing on H.B. 1376 requiring employers to pay employees at least biweekly instead of semimonthly

   Supporting Material: Testimony followed text of June 4, 1975 letter submitted prior to testimony - Copy of letter enclosed (E-2)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

E. PERFORMED AS A PUBLIC SERVICE ON THE INITIATIVE OF THE FIRM (Continued)

3. Date: July 15, 1975

Submitted to: The United States House of Representatives - Committee on Ways and Means

Initiated by: Arthur Andersen & Co.

Arthur Andersen & Co. Representatives:

Statement of Arthur Andersen & Co. was submitted without any personal appearance

Subject Matter: Taxation of International Business by the United States - The Competitive Aspects of Proposed Major Changes in the System

Supporting Material: Copy enclosed (E-3)

4. Date: October 6, 1975

Submitted to: The State of Colorado - Environment and Land Resources Subcommittee of the Senate Interior and Insular Affairs Committee

Initiated by: Arthur Andersen & Co.

Arthur Andersen & Co. Representative:

Graydon D. Hubbard, Jr., Partner - Denver Office

Subject Matter: Ski area operations

Supporting Material: Copy enclosed (E-4)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

E. PERFORMED AS A PUBLIC SERVICE ON THE INITIATIVE OF THE FIRM (Continued)

5. Date: March 1, 1976

   Submitted to: State of Wisconsin - Joint Committee for Review of Administrative Rules

   Initiated by: Arthur Andersen & Co.

   Arthur Andersen & Co. Representatives:

   John R. O'Donnell, Partner - Milwaukee Office
   Thomas W. Stock, Manager - Milwaukee Office

   Subject Matter: Current requirements pertaining to the eligibility of applicants to sit for the CPA examination in the State of Wisconsin

   Supporting Material: Copy enclosed (E-5)

6. Date: March 31, 1976

   Submitted to: United States Senate - Committee on Finance

   Initiated by: Arthur Andersen & Co.

   Arthur Andersen & Co. Representative:

   Donald M. Gamet, Partner - Chicago Office
   Vice Chairman-Tax Practice

   Subject Matter: Inflation, taxation and capital formation (Hearings on Tax Reform)

   Supporting Material: Copy enclosed (E-6)

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE THE UNITED STATES CONGRESS OR STATE LEGISLATURES
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

E. PERFORMED AS A PUBLIC SERVICE ON THE INITIATIVE OF THE FIRM (Continued)

7. Date: April 12, 1976

Submitted to: United States Senate - Committee on Finance

Initiated by: Arthur Andersen & Co.

Arthur Andersen & Co. Representative:

Donald M. Gamet, Partner - Chicago Office
Vice Chairman-Tax Practice

Subject Matter: Inflation, taxation and capital formation (Public Hearing on H.R. 10612, Extension of Expiring Tax Provisions and Other Tax Reform Proposals)

Supporting Material: Copy enclosed (E-7)

8. Date: April, 1976

Submitted to: United States Senate - Committee on Finance

Initiated by: Arthur Andersen & Co.

Arthur Andersen & Co. Representative:

Donald M. Gamet, Partner - Chicago Office
Vice Chairman-Tax Practice

Subject Matter: U.S. Companies and International Markets - the Competitive Factor in Tax Policy (Public Hearing on H.R. 10612, Extension of Expiring Tax Provisions and Other Tax Reform Proposals)

Supporting Material: Copy enclosed (E-8)

ARTHUR ANDERSEN & CO.

69 WEST WASHINGTON STREET
CHICAGO, ILLINOIS 60602

G. E. STANTON
VICE CHAIRMAN-ADMINISTRATION

May 28, 1976

Honorable Lee Metcalf, Chairman
Subcommittee on Reports,
Accounting, and Management
Committee on Government Operations
United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

To complete our April 30, 1976, response to your Subcommittee request of April 8, 1976, we submit herewith data as to public testimony or presentations made by representatives of our firm for the period January 1, 1975, to April 15, 1976, to Federal and state regulatory commissions.

We believe that the enclosed listings (Exhibit I - Before Federal Regulatory Commissions and Exhibit II - Before State Regulatory Commissions) sufficiently identify the proceedings with respect to each testimony or presentation of Arthur Andersen & Co. representatives to enable your Subcommittee to request copies of these data from the regulatory commissions, if desired.

As previously stated in our April 30, 1976, response, we were informed by a representative of the Subcommittee that we need not include data concerning private meetings or discussions with Federal or state regulatory commissions with respect to client engagements or our firm's internal affairs. We have also not included our proposals to provide professional services to regulatory commissions.

Please contact Mr. Harvey Kapnick, Chairman and Chief Executive of our firm, or Mr. Charles A. Bowsher, a partner in our Washington, D.C. office who is the Director of our Federal Government Liaison Group, or me, if we can be of further assistance in discussing these matters or providing additional information.

Very truly yours,

G E Stanton

Enclosures

EXHIBIT I

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE FEDERAL REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

A. Commission on Federal Paperwork - performed as a public service on the initiative of the firm

1. Date: February 18, 1976 - Public Hearing, Chicago, Illinois

   Arthur Andersen & Co. Representatives:

   William D. Barth and Paul Briggs, Partners - Chicago Office

   Subject Matter: Excessive paperwork required for compliance with requests of Bureau of the Census and various Federal, state and local governmental bodies regarding employment practices

B. Federal Power Commission - performed as a professional client service

1. Date: April 19, 1974 - direct testimony
   May 27, 1975 - rebuttal testimony
   June 9, 1975 - supplemental rebuttal

   Arthur Andersen & Co. Representative:

   John A. Jeter, Partner - Omaha Office

   Subject Matter: Testimony, at the request of Northern Natural Gas Company, with respect to depreciation matters (Docket No. RP74-80)

2. Date: March 17, 1975 - direct testimony
   June 25, 1975 - cross examination
   July 23, 1975 - cross examination
   November 5, 1975 - supplemental direct testimony
   December 11, 1975 - cross examination
   January 14, 1976 - additional supplemental direct testimony

   Arthur Andersen & Co. Representative:

   John A. Jeter, Partner - Omaha Office

   Subject Matter: Testimony, at the request of Alaskan Arctic Gas Pipeline Co. and Northern Border Pipeline Co., with respect to accounting principles used in preparation of pro forma financial statements (Docket Numbers CP74-239, CP74-290 and CP75-96 et al)

EXHIBIT I

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE FEDERAL REGULATORY COMMISSIONS FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

B. Federal Power Commission - performed as a professional client service

(Continued)

3. Date: March 31, 1975

   Arthur Andersen & Co. Representative:

   Richard W. Walker, Partner - Chicago Office

   Subject Matter: Testimony, at the request of Alabama Power Company, with respect to interperiod tax allocation and rate making for fuel costs (Docket No. E-8851)

4. Date: July 7, 1975

   Arthur Andersen & Co. Representative:

   Richard W. Walker, Partner - Chicago Office

   Subject Matter: Testimony, at the request of United Gas Pipeline Company, with respect to measuring return under inflationary conditions (Docket No. RP75-109)

5. Date: August 1, 1975

   Arthur Andersen & Co. Representative:

   Leonard J. Kujawa, Partner - Chicago Office

   Subject Matter: Testimony, at the request of Northern Indiana Public Service Company, with respect to items influencing cost of service and rate base (e.g., full normalization, construction work in progress in rate base and fuel adjustment clause lags - Docket No. ER76-50)

EXHIBIT I

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE FEDERAL REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

B. Federal Power Commission - performed as a professional client service

(Continued)

6. Date: March 8, 1976

   Arthur Andersen & Co. Representative:

   Richard W. Walker, Partner - Chicago Office

   Subject Matter: Statement, at the request of Southern Services, Inc., with respect to inclusion of construction work in progress in rate base (Docket No. RM75-13)

C. Federal Trade Commission - in response to request for comments

1. Date: May 9, 1975

   Subject Matter: Comment letter from Arthur Andersen & Co. dated May 9, 1975, with respect to Federal Trade Commission's proposed revisions to its Form LB, annual line-of-business report, for the 1974 reporting year, issued April 12, 1975

D. Interstate Commerce Commission - performed as a professional client service

1. Date: March 7, 1975
   May 16, 1975
   June 27, 1975
   November 7, 1975
   February 14, 1976

   Arthur Andersen & Co. Representative:

   Harold C. Hill, Partner - Kansas City Office

   Subject Matter: Statements in justification of increased motor carrier rates from, to and within the south, at the request of Southern Motor Carriers Rate Conference. Subject matter related to various accounting and reporting matters including the use of consolidated information, income taxes, leases, intangibles and differences between the accounting requirements of the Interstate Commerce Commission and generally accepted accounting principles.

EXHIBIT I

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE FEDERAL REGULATORY COMMISSIONS FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

D. Interstate Commerce Commission - performed as a professional client service

(Continued)

2. Date: March 21, 1975
   May 16, 1975
   July 9, 1975
   February 14, 1976

   Arthur Andersen & Co. Representative:

   Harold C. Hill, Partner - Kansas City Office

   Subject Matter: Statements in justification of increased motor carrier rates and charges in the Eastern Central territory, at the request of Eastern Central Motor Carrier Association. Subject matter related to various accounting and reporting matters including the use of consolidated information, income taxes, leases, intangibles and the differences between the accounting requirements of the Interstate Commerce Commission and generally accepted accounting principles.

E. Public Service Commission of the District of Columbia - performed as a professional client service

1. Date: December 29, 1975

   Arthur Andersen & Co. Representative:

   Richard W. Walker, Partner - Chicago Office

   Subject Matter: Testimony, at the request of Potomac Electric Power Company, with respect to interperiod tax allocation and ratemaking for fuel costs (Formal Case No. 651)

EXHIBIT I

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE FEDERAL REGULATORY COMMISSIONS FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

F. Securities and Exchange Commission - in response to requests for comments

1. Date: February 12, 1975

   Subject Matter: Letter of comment by Arthur Andersen & Co. dated February 12, 1975, on SEC proposed amendments to Regulation S-X to revise requirements for separate financial statements of consolidated subsidiaries engaged in financial activities, as contained in SEC Release No. 33-5548 dated December 11, 1974

2. Date: March 14, 1975

   Subject Matter: Arthur Andersen & Co. brief dated March 14, 1975, with respect to SEC proposed amendments to Regulation S-X and Form 10Q providing for certain changes in reporting quarterly financial information, as contained in SEC Release No. 33-5549 dated December 19, 1974

3. Date: May 28, 1975

   Subject Matter: Arthur Andersen & Co. brief dated May 28, 1975, with respect to SEC proposals relating to quarterly financial information, as contained in SEC Release No. 33-5579 dated April 17, 1975

EXHIBIT I

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE FEDERAL REGULATORY COMMISSIONS FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

F. Securities and Exchange Commission - in response to requests for comments

(Continued)

4. Date: June 6, 1975

Arthur Andersen & Co. Representatives:

George R. Catlett and William D. Hall, Partners - Chicago Office

Subject Matter: Oral presentation by George R. Catlett at public hearings held by SEC with respect to quarterly financial statement data and review thereof by independent public accountants; these public proceedings were announced by the SEC in SEC Release No. 34-11354 dated April 17, 1975. Copies of Mr. Catlett's oral statement were submitted to the SEC on May 30, 1975.

5. Date: June 27, 1975

Subject Matter: Arthur Andersen & Co. brief dated June 27, 1975, with respect to SEC proposed rules to permit projections of future economic performance and to require the filing of certain data when public projections are made, as contained in SEC Release No. 33-5581 dated April 28, 1975.

6. Date: July 21, 1975

Subject Matter: Letter of comment by Arthur Andersen & Co. dated July 21, 1975, with respect to SEC proposed amendments to Regulation S-X to clarify certain disclosure requirements initiated in Accounting Series Releases No. 147, 148 and 149 relating to leases, compensating balances and short-term borrowing arrangements, and income tax expense, as contained in SEC Release No. 33-5587 dated May 27, 1975

EXHIBIT I

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE FEDERAL REGULATORY COMMISSIONS FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

F. Securities and Exchange Commission - in response to requests for comments

(Continued)

7. Date: September 5, 1975

   Subject Matter: Letter of comment by Arthur Andersen & Co. dated September 5, 1975, with respect to SEC proposed amendments to Regulation S-X and certain filing forms in regard to accounting and reporting requirements for companies in the development state, as contained in SEC Release No. 33-5601 dated July 31, 1975.

8. Date: November 28, 1975

   Subject Matter: Letter of comment by Arthur Andersen & Co. dated November 28, 1975, with respect to SEC proposed Guides 61 and 3, "Statistical Disclosure by Bank Holding Companies," as contained in SEC Release No. 33-5622 dated October 1, 1975.

9. Date: January 30, 1976

   Subject Matter: Letter of comment by Arthur Andersen & Co. dated January 30, 1976, with respect to SEC proposed amendments to Regulation S-X to require disclosure of certain replacement-cost data in notes to financial statements, as contained in SEC Release No. 33-5608 dated August 11, 1975.

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE STATE REGULATORY COMMISSIONS FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

A. Alabama -

1. Date: February 10, 1976

   Submitted to: Alabama Public Service Commission, Montgomery, Alabama

   Arthur Andersen & Co. Representative:

   Richard W. Walker, Partner - Chicago Office

   Subject Matter: Testimony, at the request of Alabama Power Company, with respect to interperiod tax allocation and construction work in progress in rate base (Docket No. 17094)

B. California -

1. Date: December 2, 1975

   Submitted to: California Public Utilities Commission, San Francisco, California

   Arthur Andersen & Co. Representative:

   Kenneth A. Mounce, Partner - Los Angeles Office

   Subject Matter: Testimony, at the request of General Telephone Company of California, with respect to accounting for accrued but unpaid vacation due to employees (Application No. 55383)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

C. Connecticut -

1. Date: June 9, 1975

Submitted to: Connecticut Public Utilities Commission, Hartford, Connecticut

Arthur Andersen & Co. Representative:

Jay H. Price, Jr., Partner - Chicago Office

Subject Matter: Testimony, at the request of Bridgeport Hydraulic Company, with respect to proposed rule making on appropriate accounting for the additional investment credit allowable under the Tax Reduction Act of 1975 (Docket No. 11641)

D. Florida -

1. Date: April 22, 1975

Submitted to: Florida Public Service Commission, Tallahassee, Florida

Arthur Andersen & Co. Representative:

Richard W. Walker, Partner - Chicago Office

Subject Matter: Testimony, at the request of Tampa Electric Company, with respect to comprehensive interperiod income tax allocation and measurement of attrition (Docket No. 74597-EU)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

E. Illinois -

1. Date: April 16, 1975

   Submitted to: Illinois Commerce Commission, Springfield, Illinois

   Arthur Andersen & Co. Representative:

   Joseph Antonello, Jr., Partner - Chicago Office

   Subject Matter: Testimony, at the request of Illinois Consolidated Telephone Company, with respect to adjustments to the reserve for depreciation (Docket No. 58834)

2. Date: June, 1975

   Submitted to: Illinois Commerce Commission, Springfield, Illinois

   Arthur Andersen & Co. Representative:

   Richard Swanson, Partner - Chicago Office

   Subject Matter: Testimony, at the request of Central Illinois Public Service Company, with respect to inclusion of a portion of construction work in progress in rate base and adoption of an adjustment clause when construction levels reach a certain magnitude (Docket No. 59784)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

E. Illinois - (Continued)

3. Date: December 17, 1975
March 3, 1976

Submitted to: Illinois Commerce Commission, Springfield, Illinois

Arthur Andersen & Co. Representative:

Richard W. Walker, Partner - Chicago Office

Subject Matter: Testimony and supplemental testimony, at the request of Central Illinois Light Company, with respect to analysis of rate request and end result impact (Docket No. 60044)

F. Indiana -

1. Date: November 22, 1974 - direct testimony
May 21, 1975 - cross examination

Submitted to: Public Service Commission of Indiana, Indianapolis, Indiana

Arthur Andersen & Co. Representative:

Leonard J. Kujawa, Partner - Chicago Office

Subject Matter: Testimony, at the request of Northern Indiana Public Service Company, with respect to items influencing cost of service and rate base (e.g., full normalization, construction work in progress in rate base and fuel adjustment clause lags) (Cause No. 33920)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

F. Indiana - (Continued)

2. Date: January 7, 1975

   Submitted to: Public Service Commission of Indiana, Indianapolis, Indiana

   Arthur Andersen & Co. Representative:

   R. Paul Jasperse, Partner - Detroit Office

   Subject Matter: Testimony, at the request of Northern Indiana Fuel and Light Company, Inc., with respect to rate case (Cause No. 33828)

3. Date: January 8, 1975

   Submitted to: Public Service Commission of Indiana, Indianapolis, Indiana

   Arthur Andersen & Co. Representative:

   Mark W. Mehall, Manager - Detroit Office

   Subject Matter: Testimony, at the request of Consumers Natural Gas Corp., with respect to rate case (Cause No. 33829)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

F. Indiana - (Continued)

4. Date: April 21, 1975 - direct testimony
May 30, 1975 - cross examination
July 31, 1975 - rebuttal testimony

Submitted to: Public Service Commission of Indiana, Indianapolis, Indiana

Arthur Andersen & Co. Representative:

E. Gene Greable, Partner - Chicago Office

Subject Matter: Testimony, at the request of Southern Indiana Gas and Electric Company, with respect to increase in rates based on a test year and involving historical and pro forma cost of service for 1974 (Cause No. 33954)

5. Date: May 8, 1975

Submitted to: Public Service Commission of Indiana, Indianapolis, Indiana

Arthur Andersen & Co. Representative:

Donald A. Fleming, Partner - Indianapolis Office

Subject Matter: Testimony, at the request of Richmond Gas Corporation, with respect to accounting for cost of service in gas rate proceedings (Cause No. 33970)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

F. Indiana - (Continued)

6. Date: August 28, 1975

Submitted to: Public Service Commission of Indiana, Indianapolis, Indiana

Arthur Andersen & Co. Representative:

Donald A. Fleming, Partner - Indianapolis Office

Subject Matter: Testimony, at the request of Princeton Telephone Company, with respect to accounting effects of issuance of first mortgage bonds, and employee stock option plan (Cause No. 34164)

G. Iowa -

1. Date: July 21, 1975

Submitted to: Iowa State Commerce Commission, Des Moines, Iowa

Arthur Andersen & Co. Representative:

Richard W. Walker, Partner - Chicago Office

Subject Matter: Rebuttal testimony, at the request of Iowa-Illinois Gas and Electric Company, with respect to interperiod tax allocation (Docket No. U-483)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

H. Kansas -

1. Date: August, 1975

Submitted to: Kansas State Corporation Commission, Topeka, Kansas

Arthur Andersen & Co. Representative:

Harold C. Hill, Partner - Kansas City Office

Subject Matter: Testimony, at the request of Kansas Power and Light Company, with respect to certain emergency changes in its charges for natural gas service (Docket No. 104-864-U)

I. Kentucky -

1. Date: March 31, 1975 - filing of testimony
June 3, 1975)
July 8, 1975) - testimony

Submitted to: Public Service Commission of Kentucky, Frankfort, Kentucky

Arthur Andersen & Co. Representative:

E. Gene Greable, Partner - Chicago Office

Subject Matter: Testimony, at the request of Western Kentucky Gas Company, with respect to cost of service on both a historical and pro forma cost basis relating to the test year ending December 31, 1974 (Case No. 6241)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

I. Kentucky - (Continued)

2. Date: July 23, 1975 - rebuttal testimony
August 18, 1975 - cross examination

Submitted to: Public Service Commission of Kentucky, Frankfort, Kentucky

Arthur Andersen & Co. Representative:

Jay H. Price, Jr., Partner - Chicago Office

Subject Matter: Testimony, at the request of Louisville Gas and Electric Company, with respect to depreciation of gas distribution property (Case No. 6220)

3. Date: August 25, 1975

Submitted to: Public Service Commission of Kentucky, Frankfort, Kentucky

Arthur Andersen & Co. Representative:

Forrest D. Hayes, Partner - Cincinnati Office

Subject Matter: Testimony, at the request of Delta Natural Gas Company, Inc., with respect to adjustment of rates (Case No. 6343)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

J. Maryland -

1. Date: July 14, 1975

   Submitted to: Maryland Department of Licensing and Regulations - Insurance Division, Baltimore, Maryland

   Arthur Andersen & Co. Representative:

   Howard W. Rush, Jr., Manager - Baltimore Office

   Subject Matter: Testimony, at the request of Blue Cross of Maryland, Inc., with respect to application for a rate increase

K. Michigan -

1. Date: August 27 and 28, 1975

   Submitted to: Michigan Public Service Commission, Lansing, Michigan

   Arthur Andersen & Co. Representative

   Stanley E. Gilbertson, Partner - Detroit Office

   Subject Matter: Testimony, at the request of Consumers Power Company, with respect to income taxes related to indirect construction costs (Docket No. U-4840)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

L. Missouri -

1. Date: March, 1975

   Submitted to: Missouri Public Service Commission, Jefferson City, Missouri

   Arthur Andersen & Co. Representative:

   James H. Pendleton, Partner - Kansas City Office

   Subject Matter: Testimony, at the request of Missouri Public Service Company, with respect to accounting for income taxes and allowance for funds used during construction (Docket No. 18180)

2. Date: August, 1975

   Submitted to: Missouri Public Service Commission, Jefferson City, Missouri

   Arthur Andersen & Co. Representative:

   James H. Pendleton, Partner - Kansas City Office

   Subject Matter: Testimony, at the request of St. Joseph Light & Power Company, with respect to accounting for fuel adjustment clauses (Docket No. 18409)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

L. Missouri - (Continued)

3. Date: September 20, 1975 - direct testimony
   March 17, 1976 - updating and cross examination

   Submitted to: Missouri Public Service Commission, Jefferson City, Missouri

   Arthur Andersen & Co. Representative:

   Robert O. Palmer, Partner - St. Louis Office

   Subject Matter: Testimony, at the request of Fee Fee Trunk Sewer, Inc., with respect to pro forma rate adjustments involving recovery of depreciation on contributed property for a test year ending December 31, 1974 (updated to a test year ended December 31, 1975, with testimony on March 17, 1976) (Case No. 18396)

4. Date: September 29, 1975

   Submitted to: Missouri Public Service Commission, Jefferson City, Missouri

   Arthur Andersen & Co. Representative:

   Robert O. Palmer, Partner - St. Louis Office

   Subject Matter: Testimony, at the request of Fee Fee Trunk Sewer, Inc., with respect to rate increase involving recovery of depreciation on contributed property (Case No. 18414)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

L. Missouri - (Continued)

5. Date: October 14, 1975 - direct testimony
April 8, 1976 - submission of additional schedules

Submitted to: Missouri Public Service Commission, Jefferson City, Missouri

Arthur Andersen & Co. Representative:

Robert O. Palmer, Partner - St. Louis Office

Subject Matter: Testimony, at the request of Fee Fee Trunk Sewer, Inc., with respect to original cost findings of the staff of the Missouri Public Service Commission and the differences between the staff findings and the company accounting records (Case No. 18389)

M. Nevada -

1. Date: February 23, 1976

Submitted to: Public Service Commission of Nevada, Carson City, Nevada

Arthur Andersen & Co. Representative:

P. Gregory Conlon, Partner - San Francisco Office

Subject Matter: Testimony, at the request of California-Pacific Utilities Co., Nevada Power Co. and Southwest Gas Co., with respect to normalization vs. flow-through accounting for the tax effects of deferred fuel cost (rulemaking hearing on proposed Order No. 21)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

N. New Jersey -

1. Date: July 11, 1975

Submitted to: New Jersey State Department of Health, Princeton, New Jersey

Arthur Andersen & Co. Representative:

Donald V. Kane, Partner - Washington, D.C. Office

Subject Matter: Testimony, at the request of New Jersey Hospital Association, with respect to rate making policies and techniques prescribed by New Jersey State Department of Health for use in setting patient charge rates by the private and public hospitals in the state

O. New York -

1. Date: January 21, 1975 - direct testimony
April 1, 1975 - cross examination
June 5, 1975 - rebuttal testimony and cross examination

Submitted to: New York State Public Service Commission, New York, New York

Arthur Andersen & Co. Representative:

Jay H. Price, Jr., Partner - Chicago Office

Subject Matter: Testimony, at the request of Brooklyn Union Gas Company, with respect to normalization of tax effects of timing differences for rate making and accounting purposes (Case No. 26780)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

P. North Carolina -

1. Date: July 31, 1975

   Submitted to: North Carolina Utilities Commission, Raleigh, North Carolina

   Arthur Andersen & Co. Representative:

   Richard W. Walker, Partner - Chicago Office

   Subject Matter: Rebuttal testimony, at the request of Duke Power Company, with respect to the inclusion of a working capital allowance in rate base and the rate used to compute the allowance for funds used during construction (Docket No. E-7, SUB 173)

2. Date: April 14, 1976

   Submitted to: North Carolina Utilities Commission, Raleigh, North Carolina

   Arthur Andersen & Co. Representative:

   Wilbur S. Duncan, Partner - New York Office

   Subject Matter: Testimony, at the request of General Telephone Company of the Southeast, with respect to certain aspects of pricing of intercompany sales of industrial equipment (Docket No. P-19, SUB 163)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

Q. Oklahoma -

1. Date: April 8, 1975

   Submitted to: Oklahoma State Banking Commission, Oklahoma City, Oklahoma

   Arthur Andersen & Co. Representative:

   David O. Hogan, Partner - Oklahoma City Office

   Subject Matter: Testimony, at the request of an attorney, Mr. Jerry Nichols, with respect to pro forma statements for a proposed bank in Tulsa, Oklahoma

2. Date: April 17, 1975

   Submitted to: Oklahoma Corporation Commission, Oklahoma City, Oklahoma

   Arthur Andersen & Co. Representative:

   William M. Ulrich, Partner - Oklahoma City Office

   Subject Matter: Attended hearings, at the request of Oklahoma Gas and Electric Company, and provided assistance and testimony with respect to questions concerning fuel cost clause and the factors included in the calculations of monthly increments to rates incident thereto

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES BEFORE STATE REGULATORY COMMISSIONS FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

Q. Oklahoma - (Continued)

3. Date: September 11, 1975

Submitted to: Oklahoma State Banking Commission, Oklahoma City, Oklahoma

Arthur Andersen & Co. Representative:

David O. Hogan, Partner - Oklahoma City Office

Subject Matter: Testimony, at the request of an attorney, Mr. Jerry Nichols, with respect to pro forma statements for a proposed bank in Oklahoma City

4. Date: September 16, 1975

Submitted to: Oklahoma State Banking Commission, Oklahoms City, Oklahoma

Arthur Andersen & Co. Representative:

David O. Hogan, Partner - Oklahoma City Office

Subject Matter: Testimony, at the request of an attorney, Mr. Jerry Nichols, with respect to pro forma statements for a proposed bank in Broken Arrow, Oklahoma

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

Q. Oklahoma - (Continued)

5. Date: March, 1976

Submitted to: Oklahoma Corporation Commission, Oklahoma City, Oklahoma

Arthur Andersen & Co. Representative:

James H. Pendleton, Partner - Oklahoma City Office

Subject Matter: Testimony, at the request of Oklahoma Gas and Electric Company, with respect to income taxes (Cause No. 25567)

R. South Dakota -

1. Date: March 18, 1976

Submitted to: Public Utilities Commission of South Dakota, Pierre, South Dakota

Arthur Andersen & Co. Representative:

Richard W. Walker, Partner - Chicago Office

Subject Matter: Rebuttal testimony, at the request of Northwestern Public Service Company, with respect to the rate used to compute the allowance for funds used during construction and comprehensive interperiod tax allocation (Docket No. F-3055)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Professional Client Service

S. Texas -

1. Date: April 5, 1976

   Submitted to: Texas Railroad Commission, Austin, Texas

   Arthur Andersen & Co. Representative:

   Robert D. Rose, Partner - Houston Office

   Subject Matter: Testimony, at the request of customers of Lo-Vaca Gathering Company, with respect to cost of gas sold by Lo-Vaca to the purchasing customers (Docket No. 500)

T. Virginia -

1. Date: July 31, 1975

   Submitted to: Virginia State Corporation Commission, Richmond, Virginia

   Arthur Andersen & Co. Representative:

   Richard W. Walker, Partner - Chicago Office

   Subject Matter: Rebuttal testimony, at the request of Virginia Electric & Power Company, with respect to tax effects of tax depreciation under conditions of a change from flow-through to normalization (Case No. 19426)

EXHIBIT II

TESTIMONY AND PRESENTATIONS OF ARTHUR ANDERSEN & CO. REPRESENTATIVES
BEFORE STATE REGULATORY COMMISSIONS
FOR THE PERIOD JANUARY 1, 1975, THROUGH APRIL 15, 1976

Performed as a Public Service On the Initiative of the Firm

U. Illinois -

1. Date: October 15, 1975
December 12, 1975

Submitted to: Illinois Commerce Commission and State Regulatory Advisory Committee to the Federal Energy Administration

Arthur Andersen & Co. Representative:

Richard W. Walker, Partner - Chicago Office

Subject Matter: Testimony with respect to recent proposals relating to financial statement disclosures of price level adjustments and replacement costs

V. Missouri -

1. Date: October, 1975

Submitted to: Missouri Public Service Commission, Jefferson City, Missouri

Arthur Andersen & Co. Representative:

Harold C. Hill and James H. Pendleton, Partners - Kansas City Office

Subject Matter: An informal presentation to the Missouri Public Service Commission with respect to accounting for income taxes as they relate to rate-making practices in Missouri

Statement of Thomas A. Sampson, Vice-President, Greater Boston Chamber of Commerce, Re: The Initiative Petition to Create a Massachusetts Public Power Authority, February 19, 1975.

My name is Thomas A. Sampson. I am a Vice President and member of the Executive Committee of the Greater Boston Chamber of Commerce. During the past twenty years, I have practiced as a certified public accountant in Massachusetts. I am the managing partner of Arthur Andersen & Co. in Boston and, in that capacity, have devoted a considerable amount of time consulting on accounting and financial matters with various corporations, including public utilities.

On behalf of the Chamber of Commerce and the users of electric utility service in Massachusetts I urge your rejection of this or any other bill to establish a Massachusetts Power Authority. There are a number of reasons why we take this position and I will comment on a few of them.

Historically public ownership of production or distribution facilities has not proven to be more economical than private ownership in the absence of subsidy from Federal, State or Municipal sources.

The Tennessee Valley Authority in its region has provided lower cost power because it was subsidized by the balance of the country. It operates and responds very effectively to its cost increases by simply increasing rates without any participation by citizen groups or regulatory agencies. It acts just as the proponents of a Massachusetts Power Authority say that they will act and I quote "No consumer will ever deal directly with the Authority." That well may be the only promise they will keep.

Unlike the T.V.A., a Massachusetts Power Authority will depend for its subsidy on the citizens it proposes to serve. The sheikdom of Salem will not hit us with higher fuel costs. Rather, fuel adjustment clauses will be replaced with purchased power adjustments or, like another famous authority of ours, an assessment on cities and towns. When that becomes too burdensome, an assessment against State tax revenues—and when that becomes too burdensome maybe, just maybe, the Federal government will pick up the tab. Present proposals by the Federal government on fuel costs make that a rather remote possibility.

However, the proponents assure us that "The Authority will not use tax money to finance its facilities." Now, hear the circular reasoning they go through to explain why this is so—they will sell revenue bonds (no one knows at what cost)—they will pay the bonds off with revenues collected from selling power—and who will pay for the power? Every citizen in Massachusetts who owns a lamp. Tax money will come from our left pocket, and power money from our right pocket.

Let us bypass, as the proponents of public power have, the means by which we will pay for the start-up and construction costs of the power authority. There will be nothing to sell for several years, but perhaps Saudi Arabia will advance the funds in exchange for a long-term fuel contract.

We are also assured that with a power authority, and again I quote, "No community in Massachusetts will lose one dime of revenue because of this proposal." That is an empty promise. Let me put it another way: no community in Massachusetts will lose one dime of revenue if this proposal is rejected.

The State of Massachusetts is already burdened with financial problems of great magnitude. We have confidence and hope for their eventual solution. Adding another agency or authority to the list is not calculated to improve the possibility of solving existing problems. Indeed, our experience so far with the transit authority does not suggest public ownership as a panacea for low cost service or good service at any price.

One of the great hopes for Massachusetts is an improvement in the economic climate, which will attract the investor capital needed to expand our present industry and perhaps bring about the relocation of others to Massachusetts. In another fit of superficial and circular reasoning, proponents of public power would have you believe that private capital will look favorably on a state which expropriates the utility industry. The providers of private capital are not so naive as to believe that a state which embraces the philosophy of public ownership of productive facilities is a sound investment risk. Nor will they believe that other industries are not open to the same kind of action. They are not so lacking in judgment that they will perceive state ownership as the answer to Massachusetts' or New England's energy problems.

Massachusetts needs jobs. It needs greater financial stability. It needs relief from its high cost of energy. It cannot answer those needs by placing everyone on the State payroll, by incurring an additional two billion-plus dollars in debt, by wishing away or pretending to pass off to someone other than the consumer our high energy costs.

There are several constructive and positive steps the legislature and the State Administration could take to solve, or at least reduce, the burden of higher fuel costs.

The General Court is already seriously considering means to permit fuel-switching which would save the consumer approximately 90 million dollars annually. It is our sincere hope that such a measure be adopted without delay. Environmental impact studies can best be conducted under the realities of fuel-switching.

Steps should also be taken to review and act upon deepwater port studies already completed.

Further, the Commonwealth should undertake or permit a study for the location of an oil refinery in Massachusetts. The study should direct itself to minimizing the inconvenience such construction might entail.

Both the public and private sectors in Massachusetts should bring pressure to bear to see that the issues surrounding the construction and operation of nuclear power plants are resolved on a timely basis, to see that the country's vast coal reserves are brought more swiftly into the energy picture. Last but not least, we must make up our minds to exploit the potential gas and oil reserves off our coastline, or agree, without laying blame on someone else, that we will pay the higher price of not pursuing that possibility.

I respectfully urge your opposition to the superficial proposal that a State power authority is the answer to our problems.

Before The
Committee on Ways and Means
U. S. House of Representatives

TAXATION OF INTERNATIONAL BUSINESS BY THE UNITED STATES—THE COMPETITIVE ASPECTS OF PROPOSED MAJOR CHANGES IN THE SYSTEM

Statement of

ARTHUR ANDERSEN & CO.

JULY 15, 1975

SECTION 1

INTRODUCTION

GENERAL

It has been our experience that decisions to make substantial investments in other countries generally are not primarily tax-oriented decisions. Without question, taxes are a consideration in any such decision. However, the preference among U.S. businesses is to make investments in other countries only when necessary. A basic preference exists for manufacturing and selling from the United States. Many factors are involved in such a preference, a key one being the need to carefully allocate and utilize two very scarce commodities, capital and management talent.

It is clear to us that, when business opportunities exist in other countries throughout the world, business entities from some country will take advantage of those opportunities. Thus, if economic factors, government restrictions or other considerations make it difficult or impossible for U.S. companies to make an investment and enter into business in a particular country, that opportunity will be taken advantage of by businesses of other countries such as Japan, Germany, France and Italy. Recent worldwide investment activity by companies headquartered in other industrial nations, particularly German and Japanese companies, clearly demonstrates this fact.

There are presently under consideration two major changes relative to the taxation of international business: (1) taxation of the earnings of controlled foreign subsidiaries without regard to repatriation of the earnings, and; (2) the elimination or substantial modification of the foreign tax credit. This statement analyzes the effects either or both of these changes, if enacted, would have on U.S. businesses and on the U.S. economy.

We have compared the taxation by the United States of international business of United States companies with the taxation of similar activities of their national companies by the following countries: Belgium, France, Germany, Italy, Japan, the Netherlands and the United Kingdom. It is our view that these countries represent the major commercial competitors of the United States in the international trade area. Since the businesses of these countries are those which principally compete with United States-based business, the taxation of those companies by their home countries is a very important factor in determining their ability to compete with U.S. companies.

The remaining sections of this statement provide the analysis leading to our conclusions which are stated immediately below. Section 2 describes the consequences to U.S. business of a tax on unremitted foreign earnings and Section 3 describes the consequences of elimination or substantial modification of the foreign tax credit. These sections compare the effect of the

tax laws of our major competitors with U.S. tax laws and illustrate the economic impact on the competitive position of U.S. business assuming the contemplated tax changes are made (Exhibits I through VI). Appendices A through G describe in detail how each of the seven major countries taxes foreign income. Exhibit VII illustrates the fact that foreign governments (and *not* the U.S. Treasury) would collect most of the revenue generated from the taxation of unremitted earnings.

CONCLUSIONS

Our analysis shows that most of the seven nations presently tax international earnings of their national companies substantially more favorably than does the United States. It further shows that in none of those countries do the tax laws provide more restrictive taxation of international business than does the tax law of the United States. As a result of these comparisons, we feel that if either or both of the above-described changes were enacted, United States international business would, over a period of time, lose much or all of its present ability to operate successfully in many overseas markets.

Our specific conclusions are described in detail below.

Taxation of Unremitted Foreign Earnings

If the United States imposes a tax on unremitted foreign income, as earned (and continues to allow a foreign tax credit), we believe the following will occur:

1. U.S. corporations will be required to pay a higher current tax, thereby creating a need to raise additional funds or divert funds from present productive uses.

2. Since the increased tax cost will not be applicable to foreign-owned competitors, this development will raise the relative costs and reduce the relative profitability of U.S. companies in the affected market and thus weaken their competitive position in those markets.

3. The greatest portion of the assumed additional tax revenue will be collected by foreign governments rather than the U.S. Treasury. In the long run, we question whether much revenue will be collected at all because of the negative impact of such tax changes on U.S. international business.

4. Many of the tax incentive allowances presently granted by foreign countries to U.S. businesses will, because of the absence of any real benefit, either be unused or become unavailable.

5. Foreign-based companies will be able to more effectively compete with U.S. companies due to their lower working capital needs and financing costs. Thus, foreign-owned companies will become more

successful in international markets as U.S. companies become unsuccessful. Over a period of time, this may well materially shift the balance of economic power among companies and nations.

6. In the long run, as U.S. companies lose economic base in this manner, they will become more vulnerable to a loss of position in the U.S. market also. Foreign competitors will utilize their additional economic strength to advantage to increase their overall business, initially in other international markets and ultimately the United States market.

The first four of these consequences are discussed in greater detail in later sections of this statement. Regarding conclusions five and six, because of the absence of empirical data and criteria for judging the precise impact of the first four consequences, it is not possible to make a quantitative determination of their effects on U.S.-owned businesses or on their foriegn competitors. However, past experience amply demonstrates that unilaterally severe U.S. taxation policy actively assists foreign-owned competitors of U.S. companies to strengthen their position in international markets.

Initially the advantage to foreign competitors would be a direct monetary benefit, i.e., lower working capital requirements and financing costs. This will permit foreign-based companies to be more aggressive in establishing and strengthening operations in other countries, in setting prices in international commerce and to generally use the tax differential (and any other competitive advantage) to improve its position. Some U.S. companies will be forced out of a market; others will find their share of the market stagnate or drop. U.S. taxation of unremitted foreign earnings can be expected to soon result in foreign-based companies increasing their economic base throughout the world with an increase in their technical and managerial know-how at the expense of U.S.-based companies.

Foreign-based international companies selling or operating in the U.S. are already quite strong. Commerce Department statistics show that the value of foreign direct investments in the U.S. was approximately $13-14 billion during the period 1970-72, but jumped to $17.7 billion in 1973, the latest year for which published figures are available. This investment growth has been accompanied by a substantial increase in imports of goods produced by foreign-based companies. There have been substantial acquisitions of U.S. companies by foreign-based companies. These demonstrate quite clearly the economic muscle of many foreign-based companies and their ability to bring that economic strength to bear in the United States.

Thus far, the major foreign inroads into U.S. markets have largely been limited to a few industries such as textiles, footwear and electronics, industries in which U.S. companies have not been traditionally involved in significant investment outside of the United States, and the automobile industry which

does have significant overseas investments. Since more stringent U.S. taxation of industries with important international business would strengthen their already strong competitors in the competitors' worldwide economic activity, that new strength must eventually be felt in the U.S. markets also. The final outcome from this could not be accurately predicted, but it could not be good from the standpoint of the overall U.S. economy.

A logical way (to some people) to limit foreign competition would be to impose high duties, quotas or other restrictions on imports into the United States. It is clear, however, that protectionist actions on our part would be met by retaliatory actions on the part of other nations. The net impact on the U.S. economy of such import restrictions thus may well be a negative one. Retaliation could lead to calls for counter-retaliation and the cycle would start again. The end result could be economic disaster for the world. No serious-minded person could in good conscience advocate that such a movement should be set in motion.

Proponents of legislation to tax all unremitted earnings of foreign subsidiaries of United States companies refer to this as ending deferral of tax. Their position is that "equity" among United States taxpayers requires that concept of ability to pay be applied to all sources of income controlled by U.S. taxpayers, regardless of whether the taxpayers' relationship to the United States contributed anything to earning the income or imposed any cost on the United States government. Taxation by the United States of operations outside of the United States should not be based on such a warped idea of "equity" or "neutrality." There is no logic to imposing U.S. taxation merely because of U.S. ownership of the business operation involved. Unless the overseas operations in some way directly reduce U.S. taxes, there is no inequity in not taxing the profits which are reinvested in the overseas operation. The fact that the other government involved is less interested in collecting revenue currently than the United States would be under similar circumstances, is no reason for the U.S. investor to lose the resulting benefit.

We believe a philosophical-political question is involved in this situation, but it is not the one being debated. The real issue is not, "Is the current taxation of unremitted earnings of foreign subsidiaries necessary to achieve 'equity' among the United States taxpayers?" Instead, the issue is, "Is the United States willing to risk driving many U.S.-based companies out of a number of foreign markets and further to risk subsequent major foreign inroads into U.S. markets in pursuit of a theoretical and unrealistic concept of equity in taxation?"

In summary, the immediate taxation of all overseas earnings of U.S.-based companies or their subsidiaries would have little or no effect on overall business carried on in other countries; it would merely shift ownership of such business away from U.S.-based control. Over a period of time, this would effect a shift in the balance of economic power that would further

react to the detriment of U.S.-owned business everywhere including in the United States. As is demonstrated in Section 2 of this statement, the tax revenue generated from the proposed changes would flow primarily to foreign governments; thus, the net result to U.S. citizens and their combined interests would be a minimum of benefits at a maximum of cost.

Elimination or Significant Modification of Foreign Tax Credit

If the United States were to eliminate the foreign tax credit, the combined effective U.S. and foreign tax rates imposed on most foreign earnings of U.S. businesses would be at a prohibitive level as compared to the effective tax rates of foreign competitors. Much of U.S. investment overseas could not survive such a tax burden.

As can be seen from our summary of foreign taxation principles and the related foreign tax credit provisions described in Section 3 and Appendices A through G, competitors of U.S. companies basically are not taxed on income from their foreign operations or are given an adequate foreign tax credit. The only exception to this basic situation is Italy where only a partial foreign tax credit is allowed. Companies of those countries operating throughout the world generally would be subject to total tax rates on remitted earnings ranging from 21% to 66% (see Exhibit VII). A comparison of these percentages with those which would be applicable to U.S. companies if the tax law were changed clearly shows the economic importance of the continued existence of the U.S. foreign tax credit. As can be seen from Exhibit VII, imposing U.S. tax of 48% on the residual profits (with no foreign tax credit allowed) would make the total tax cost range from 59% to over 82%. Could there be a better illustration of prohibitive double taxation costs?

We also believe that significant modifications of the present foreign tax credit by eliminating one of the principal limitations (overall or per country) or by significantly limiting the amount of credit in some other way, would be very detrimental to that competitive position. While a comparison of our credit mechanism with that of other countries would indicate that ours is more favorable overall, that comparison does not tell the real story. The lack of a complete credit or the availability of only one limitation by other countries is of little consequence if large parts of the foreign income are not taxed. Thus, when a French company pays tax on only a limited basis on its dividends from foreign subsidiaries, the fact that French tax law does not allow a meaningful deemed tax credit and only has one tax credit limitation is of very little importance. Basically, our country taxes foreign income more broadly than most of our foreign competitor nations; we, therefore, need more flexibility in the foreign tax credit.

Under our present credit system, each of the two major limitations (per country or overall) on the foreign tax credit is necessary for certain inter-

national businesses, but neither is appropriate for all international businesses. The nature of a specific business operation dictates which limitation is most appropriate for it. Therefore, under our existing system, there is no sound basis for requiring the use of only one method by elimination of either method or for placing further important restrictions on the amount of credit allowed.

We fail to see any logical rationalization for the elimination or substantial modification of the foreign tax credit. Its time-honored objective has been to avoid double taxation. That objective is just as applicable today as it ever was. Unless the credit, as presently constituted, acts to reduce U.S. tax on *U.S. income* below what that tax would be if there were no international operations, its success should be measured by its avoidance of double taxation and there would be nothing gained in terms of equity in changing it significantly.

The major risks of higher taxation through a change in the credit are the same (only worse) as those relating to taxation of unremitted earnings described above. If the credit were to be eliminated completely and unremitted earnings were to be taxed, the result would be an immediate withdrawal of U.S. business from almost every international market. Those companies which found it essential to remain active in international operations would probably have to seek a method of removing those operations from U.S. taxing jurisdiction by selling part of the operations or by moving their headquarters outside of the United States.

If there were no current taxation of unremitted earnings, the elimination of the credit would create a withdrawal of U.S. business from basically all international markets (or a transfer of those investments from U.S. ownership) on a delayed, but still final, basis. The substantial modification of the credit would remove U.S. business from certain international markets, depending upon the industry involved, the local taxation in the market and the modification made in the credit mechanism.

Thus without the foreign tax credit in much its present form, the continued existence of foreign investment by U.S. business (in total or in significant part), which is subject to prohibitive taxation, would not be practicable. Foreign-based firms would therefore become even more capable of competing in other countries. The consequence again could be major foreign inroads into U.S. markets and further weakening of U.S. business.

1962 Ways and Means Decision—Still Valid

In summary, if unremitted earnings are taxed or our foreign tax credit is eliminated or substantially modified, foreign companies will, in most instances, end up with a substantial economic advantage from U.S. taxation of U.S. companies. As was stated by your Committee in its Report on the Revenue Act of 1962:

"Your Committee's bill does not go as far as the President's recommendations. It does not eliminate tax deferral in the case of operating businesses owned by Americans which are located in the economically-developed countries of the world. Testimony in hearings before your Committee suggested that the location of investments in these countries is an important factor in stimulating American exports to the same areas. Moreover, it appears that to impose the U.S. tax currently on the U.S. shareholders of American-owned businesses operating abroad would place such firms at a disadvantage with other firms located in the same areas not subject to U.S. tax." (H.R. Rep. No. 1447, 87th Congress, 2d Session 5708 (1962)).

We believe this statement regarding foreign competition and U.S. exports has even greater applicability in 1975 when foreign competitors of U.S. companies are infinitely stronger than in 1962 and the United States economy, at best, can be described as questionable.

(Staff note: The rest of the Arthur Andersen statement and other enclosures are retained in committee files.)

(Staff note: The following is an excerpt from a hearing on market performance and competition in the petroleum industry before the Special Committee on Integrated Oil Operations of the Committee on Interior and Insular Affairs, United States Senate, February 21, 1974. The witnesses being interrogated by Senator Dewey F. Bartlett of Oklahoma are Randall B. McDonald, a partner of Arthur Andersen & Co., and Robert E. Field, a partner of Price Waterhouse & Co.)

Senator BARTLETT. Thank you, Mr. Chairman.

Mr. McDonald, on page 19 you have a chart to which you referred, "Rates of Return on Equity." Do you know how the rate of return on equity of the oil companies compares with other major manufacturers or major industries?

Mr. McDONALD. Do I know how it compares? In the aggregate on page 20 I have shown how they compare on the basis with all manufacturing companies as a group as reported by the First National City Bank. I should point out, I would like to point out, and this is something I intended to do initially, that after submitting this data to the committee, I discovered that there is one slight variance in the computation of the data between the data that I calculated for the oil companies and the data the First National City Bank calculated for the manufacturing companies in the aggregate. That difference is that I used yearend equity to calculate rate of return, as explained in my exhibits, because this is the information that was more readily available to me and I felt it would be better to use precise information rather than something that I would have to guess at. I did learn later on, that First National City Bank in calculating their rates of return used beginning of the year equity. I did make some calculations as to what effect that would have on this graph that I used beginning with the year equity as best I can arrive at and in each case the rate of return for the two bottom lines would be increased from two-tenths of 1 percent to four-tenths of 1 percent.

Senator BARTLETT. So you are saying, Mr. McDonald, that with that alteration there is still a substantial difference in the rate of return, and it is less for the oil companies?

Mr. McDONALD. Right, based on full-cost method of accounting which I have adjusted the companies to.

Senator BARTLETT. Mr. Field, would you comment on that, as to your opinion as to whether the return on equity of oil companies is less, and does this graph in your opinion substantially show it, if you have an opinion of that?

Mr. FIELD. Less than other industries?

Senator BARTLETT. Yes.

Mr. FIELD. Yes. My source is the Chase Manhattan survey which I think you already have on record.

Senator BARTLETT. Mr. McDonald, do you consider the 30 largest integrated oil companies competitive?

Mr. McDONALD. Do I consider them competitive? Yes, sir, I do.

Senator BARTLETT. Do you consider the other oil companies besides the 30 largest competitive?

Mr. McDONALD. Yes, I consider those companies also very competitive.

Senator BARTLETT. Mr. Field.

Mr. FIELD. Senator, I have seen no indication in all my years of experience of anything other than competition in the oil industry, in all segments of it.

Senator BARTLETT. Mr. Field, you mentioned, I believe on page 3, some of the other characteristics of extractive operations significant

to financial reporting, and Mr. McDonald made reference, I believe, to the same thing, "Discovery costs bear little or no predictible relationship to the potential market value of the minerals found." Would these be some of the reasons why the Federal Power Commission did not see fit, with its cost method, to provide sufficient pricing so that there would be sufficient reserves of natural gas? Do you see this as one of the reasons why there was not the incentive that there should have been?

Mr. FIELD. Senator, I don't know that this particular unique feature of extractive industries entered into the Federal Power Commission's approach to the pricing of natural gas of independent producers at the wellhead. I would agree with what I believe you just stated, that the prices were unnaturally depressed with the Federal Power Commission's regulation. I believe the Federal Power Commission followed a traditional method. The utility rate base method of accounting with which I took exception at the time and still do, because they were not dealing with a service such as a long-line gas transmission company. They were dealing with a commodity which had a value in the ground completely unrelated to the cost of finding, a commodity which when it got on the marketplace was really competing with other heat-content sources such as coal and the like. So I think the disaster that resulted from the Federal Power Commission's regulation, they were well intended, but it was a disaster; I think it occurred because they tried to apply traditional methods of regulation to an industry where those methods were not applicable because the circumstances of the industry's operation were completely different.

Senator BARTLETT. Are you of the opinion, Mr. Field, that the oil companies have had to sell their natural gas and crude oil at prices that are less than replacement cost?

Mr. FIELD. I have made no studies, Senator, on which I could base that. The tendency is always in that direction because, as Mr. Mc Donald pointed out, the costs of finding additional reserves are increasing very rapidly. It is becoming more and more expensive, so if prices in some fashion are beared to cost of yesterday then they are going to fall behind or not keep up with the increased cost of replacing that product.

Senator BARTLETT. In addition to that point that Mr. McDonald made, there is also the point that I think he also made, that there are costs incurred in the total exploratory operation that are not applicable to a particular successful venture and well, or series of wells?

Mr. FIELD. That's right, there are, and that is the crux of difference between full cost and successful efforts methods of accounting.

Senator BARTLETT. Mr. McDonald, would you be of the opinion that oil companies have had to sell their products at less than replacement cost as far as natural gas and crude oil are concerned?

Mr. McDONALD. In the past years, up until recent months, it is my judgment that based on a sales price of approximately $3.50 a barrel that oil companies could not currently go out, search for, refine, and

develop oil and gas reserves and under those prices return a reasonable profit. That is my judgment and my opinion.

Senator BARTLETT. I have heard it said that because of that, that what the free market price, as far as new oil, matching oil and stripper oil today, is requiring a price that is sufficient to replace the gallons of gasoline that is purchased at the filling station, plus a little more that is not purchased in order to bring up supply to demand. Is that a kind of nonprofessional way of describing the higher prices and the need for supply to be brought up to demand?

Mr. McDONALD. I am not sure I followed your question, Senator, but let me ask it in another way and see if this is what you are asking.

Under the two-tier pricing system, it is my understanding that prices of new oil and stripper oil have gone up to an average of somewhere between $8 and $10 a barrel. If your question is whether, in my judgment, that is sufficient to replace oil and gas and return a reasonable profit to the industry, yes, in my judgment that would be a reasonable price and I think that those prices that sufficient capital would be attracted to the industry to look for this additional oil and gas. I do not know that anyone can say what the cost of finding will be on the Atlantic seaboard, for example. But articles that I have read indicate that there is every reason to believe that there are significant oil and gas reserves on our eastern seaboard, but I am convinced that they will be very expensive to find. And I would say that when all of the facts are known 20 years from now of what it costs us to find the oil and gas that we are going to need over that period of time to keep our economy strong, that somewhere in that range, based on today's dollars, will be that cost which will yield a reasonable return.

Senator BARTLETT. That was really part of the question. Let me try it again.

It is not necessary today to have a price, whatever that price might be, sufficient to replace the energy used and to go beyond that and add to the supply and, in addition, to be such that it would add to the supply to bring the supply up to the demand, at least closer to the demand for 85 or 90 percent self-sufficiency, in addition to that to bring on other sources of energy?

Mr. McDONALD. In my judgment, yes. If this industry is forced to sell its accumulated inventory of reserves at the cost it might be booked now, then sufficient capital will not be attracted to the industry to replace that oil and to act as an incentive for other energy to be developed.

Senator BARTLETT. Mr. Field, would you care to comment?

Mr. FIELD. Senator, I am a firm believer in the role of prices and profits in bringing about a relocation of priorities and resources, both as to consumer wants and as to the allocation of capital, and to bring about a greater supply where profits indicate that to be an attractive situation for the investor. So that would, if I understand, my interpretation of your question is that do I feel that to let the market, let the prices of crude oil and gas run free in the marketplace,

would that in the long run serve the country better than to hold it back. I say yes, I believe it would.

Senator BARTLETT. What do you think, Mr. Field, would be the result of the action of the Senate 2 days ago in adopting the Federal Energy Act with the provision—I am referring specifically and mainly to the provision of the rollback fixed price with a limited increase? We are using the figure from the Federal Energy Office of $9.05, being the price of the oil involved and rollback to a price of $5.25, and a possible increase up to $7.09?

Mr. FIELD. Senator, I am not an economist, but speaking from my viewpoint of the proper role of profits and price in the economy, I believe that for the long run this would have a bad effect upon the supply of energy available to the consuming public and a bad effect on the consumption of energy by the public. It seems to me we have a long-range energy crisis ahead of us. We are consuming in increasing amounts a limited resource and until we find some alternative supply of energy on an unlimited means we are continually demanding more from a resource which is limited in nature, and the price simply has to go up. That in turn, it seems to me, will encourage investment in the industry, production and exploration of further mineral reserves. At the same time I really believe that we will bring the consumer to think again about how much gasoline he uses, how much he drives his car, how much he heats his house and so forth. We have all been wasteful in energy in this country. I think from that standpoint a higher price would be beneficial to us as consumers.

Senator BARTLETT. Mr. McDonald, would you also comment on that question?

Mr. McDONALD. Yes, I would agree with everything Mr. Field has said. I would like to add a couple of comments on that. I am a great proponent of the free enterprise system that we have in this country and I sincerely hope that we keep that system. At the same time I also believe that no company or individual should have an unfair competitive advantage and I think we have laws to prevent that. In the long run I believe the free enterprise system will serve us all best. I think we have all seen what happened to our gas reserves under a controlled environment at unrealistically low prices in relation to replacement cost. I think had that not happened, had these prices been allowed to seek their levels with competitive fuels that our gas reserves today would be much higher. I think it is indeed unfortunate that that did happen but that is many years ago and we can't do anything about that now, what happened in the past.

I also think it is unfortunate that the industry in these hearings has not come forward with detailed studies as to what it costs today and will cost in the future to find oil and gas and to argue about that and now what the current profits are based on yesterday's cost and yesterday's accounting.

Senator BARTLETT. Would you have such information available or is it available to submit, or could it be made available?

Mr. McDONALD. I do not have such information as to current replacement cost. I think I have a feel for that information, but I think

the companies themselves certainly must have it and have a good knowledge as to what it is and what it will be in the future.

Senator BARTLETT. Thank you, Mr. McDonald and Mr. Field. Mr. Chairman.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SECURITIES ACT OF 1933
Release No. 5512/ July 8, 1974

SECURITIES EXCHANGE ACT OF 1934
Release No. 10906/ July 8, 1974

ACCOUNTING SERIES
Release No. 157/ July 8, 1974

Admin. Proc. File No. 3-4430

In the Matter of

ARTHUR ANDERSEN & CO.

Rule 2(e) of the Rules of Practice

FINDINGS AND OPINION ACCEPTING WAIVER CONSENT AND IMPOSING REMEDIAL SANCTIONS

In May, 1973 information came to the attention of the Commission which indicated that the Commission and the public had not been fully informed of the facts relating to a settlement negotiated between Whittaker Corporation ("Whittaker") and its auditors, Arthur Andersen & Co. ("Arthur Andersen") arising out of an audit performed by Arthur Andersen of the inventory of a subsidiary of Whittaker. Accordingly, the Commission ordered a formal investigation into this matter which confirmed that public disclosure and disclosure of this settlement to the staff had been incomplete. As a result of this investigation, an injunctive proceeding was instituted on February 8, 1974 against Whittaker and the captioned proceeding pursuant to Rule 2(e) of the Commission's Rules of Practice was instituted thereafter.

Since the proceedings were instituted, Arthur Andersen, solely for the purposes of settling this matter, and without admitting or denying any of the allegations, findings or conclusions has consented to the entry of an order censuring the firm and to the publication of certain findings and conclusions by the Commission. For purposes of this settlement, Arthur Andersen has waived separation of functions and consented to the staff's participation in the preparation of this order and opinion.

The Arthur Andersen settlement with Whittaker arose out of its audit of the inventory of Crown Aluminum Corporation, a major subsidiary of Whittaker, as part of its examination of the financial statements of Whittaker Corporation for the fiscal year ended October 31, 1971. Subsequent to this examination, in connection with the proposed sale of

Crown, a physical inventory was taken which indicated that inventory on the books exceeded physical inventory on hand by approximately 100%. In the subsequent investigation, it was determined that the inventory overstatement resulted from the fraudulent alteration of inventory records by Crown management and other Crown personnel. By recreation of inventory records, it was calculated that the $9.2 million book inventories of Crown at October 31, 1971 were overstated by approximately $4.4 million, and that income for fiscal years 1970 and 1971 was overstated. Of this total shortage, approximately $2.5 million occurred at Crown's Roxboro plant. The Roxboro physical inventory had been observed by Arthur Andersen.

In connection with this observation, the Arthur Andersen auditors did not adequately control inventory count tags even though the firm's own procedures require such control. Accordingly, Crown personnel were able to alter certain tags and to create other tags which were included with actual count tags prior to the tabulation of the inventory. In addition, the fraudulent tags were printed out in numerical sequence on the inventory tabulation listing and indicated quantities of aluminum coil in units of 50,000 pounds per coil which are quantities in excess of that which could have been reasonably expected to be physically contained in the Roxboro plant or any other plant. The plant did not manufacture or purchase aluminum coils in excess of 5,000 pounds. The auditors and any reviewers of the inventory work papers did not notice this block of 100 tags which constituted a substantial portion of the total inventory on the computer listing with quantities 10 times as large as the largest actual inventory item. Normal inventory auditing procedures would require that special attention be paid to the largest items in the inventory.

Further, this inventory observation took place under circumstances which should have warranted special care. Arthur Andersen was aware that in 1969 and 1970 certain inventory tags originally accounted for as unused were included as used by Crown in the computer runs. Arthur Andersen also knew that Crown's system for accounting for the inventory resulted in differences between the physical and book inventories among various subcategories, though not in net amounts.1/ Further, the 1971 audit took place in the context where an internal Arthur Andersen memorandum had expressed questions concerning the "credibility" in other respects of Crown's management.2/

In the judgment of the Commission, Arthur Andersen did not follow generally accepted auditing standards in the audit of Crown's inventory, and must share responsibility for the misstatements which resulted, even though it is apparent that the firm was the victim of a deliberate scheme to defraud perpetrated by certain management, supervisory and plant personnel of Crown.

The Commission has been advised that Arthur Andersen has taken steps to prevent the recurrence of similar audit deficiencies. The firm has thor-

oughly reviewed the audit program used to audit Crown's inventory in order to make the most constructive use of its experience in this regard. While Arthur Andersen did not find that the programs themselves were deficient within the parameters for which they were designed, nevertheless it has revised its audit guides in such a way as to enable reviewing personnel to detect breakdowns in audit procedures such as occurred here. Further, Arthur Andersen is in the process of preparing a case study of the Crown Aluminum situation. This case study will be used in Arthur Andersen's staff training program in order to alert its professional staff to situations of this nature and to make its professional staff more aware of the areas in which a fraud can be perpetrated and the methods used to cover up such fraudulent conduct.

In addition, the Arthur Andersen personnel involved in the audit on both a staff and a supervisory level have either left the firm or been reassigned to responsibilities not related to the firm's professional practice.

The Commission believes that these corrective measures and the settlement negotiated at arm's length with the party damaged make unnecessary any further action by the Commission in regard to the inventory auditing deficiency. Subsequent actions by Arthur Andersen in the disclosure of the settlement and related matters require further discussion and action.

Promptly following discovery of the inventory problem, Whittaker and Arthur Andersen agreed that it would be desirable to conduct a comprehensive review of the company's accounting systems and internal controls and an examination of its major inventories as well as to engage in a balance sheet audit of expanded scope at the end of the 1972 fiscal year in order to assure both Whittaker and Arthur Andersen that similar problems did not exist at operating units in addition to those discovered at Crown. Initially, Arthur Andersen offered to conduct this review, to assist in the implementation of any recommendations, and to perform the expanded scope audit work at "loan staff rates," approximately one-half of Arthur Andersen's normal billing rates, which would approximate its out-of-pocket costs. At the time, Arthur Andersen estimated that the review work, if billed at normal rates, would amount to approximately $340,000. At Whittaker's request Arthur Andersen agreed to perform the review at no charge. Arthur Andersen also said to Whittaker that it would assist in performing any systems work recommended in the review at approximately one-half the normal billing rates.

At about the same time, Whittaker retained special counsel to determine whether it had a cause of action against Arthur Andersen. It did so because it was of the belief that Arthur Andersen had conducted an inadequate audit in connection with Crown's inventory. Because Whittaker's own investigation relating to the cause of the inventory discrepancies was not then completed, it was decided that the company would defer determining whether it had a cause of action against Arthur Andersen until the results of investigation were known. Whittaker did not advise Arthur Andersen that Whittaker was evaluating its legal rights against Arthur Andersen. Following the con-

clusion of its investigation into the cause for the inventory discrepancies, and in December 1972, after Arthur Andersen had completed its review of Whittaker's accounting systems and internal control and issued a report thereon, Whittaker was advised by its special counsel as well as its General Counsel that in their opinion Whittaker had a cause of action against Arthur Andersen. This conclusion was communicated to Whittaker's Board of Directors, which decided that the company should pursue its claims against Arthur Andersen. However, because Arthur Andersen was then in the process of completing its audit of Whittaker's 1972 financial statements, and Whittaker was concerned that the assertion of a claim might jeopardize the ability of Arthur Andersen to complete its audit, Whittaker intentionally withheld from Arthur Andersen any indication that Whittaker intended to assert a claim against Arthur Andersen.3/ On December 28, 1972, the board of directors decided to assert a claim against Arthur Andersen but concluded that it should not be brought to Arthur Andersen's attention until Arthur Andersen had completed its audit and had signed its report on Whittaker's financial statements which was to be included in a registration statement to be filed with the Commission in a few days.

On January 4, 1973, Arthur Andersen executed its report on Whittaker's financial statements for the fiscal year ended October 31, 1972. The auditor's report and financial statements were contained in a registration statement filed with the Commission by Whittaker on January 5, 1973. On the same day that the registration statement was filed with the Commission, officers of Whittaker advised Arthur Andersen that Whittaker felt it had a claim against Arthur Andersen. At that time, Whittaker asserted a claim of approximately $3 million against Arthur Andersen. During the month of January 1973, there followed a number of meetings between top officers of Whittaker and senior partners of Arthur Andersen. During these meetings, Arthur Andersen indicated that the pending claim against it jeopardized its independence and therefore that it would be unable to sign amendments to the pending registration statements. Whittaker told Arthur Andersen that if the issues were not settled, Whittaker would not be able to recommend Arthur Andersen to its shareholders in connection with the next shareholder's meeting. On January 30, 1973 personnel from Whittaker and Arthur Andersen met to see if they could resolve their differences.

During the negotiations, Arthur Andersen maintained that it would not settle for any amount in excess of $1 million. Initially, they offered to settle by paying Whittaker $500,000 in cash. They also proposed to establish a ceiling of $250,000 at loan staff rates for the implementation work relating to the recommendations of the previous review in accordance with the agreement made prior to the review. At that time, they explained that Whittaker was going to receive almost $2 million: $500,000 in cash, $250,000 in free services at loan staff rates equal to $500,000 in normal billings, plus the $1 million in free services that had already been performed. This was the first time that Whittaker

had been advised that the review work Arthur Andersen had previously performed without charge to Whittaker would have cost approximately $1 million at normal billing rates and not the originally estimated $340,000. Whittaker, however, insisted upon a minimum of $1 million in cash in addition to the $250,000 loan staff assistance which Arthur Andersen had offered, for a total of $1,250,000. After several intermediate offers, Whittaker finally offered to settle on a cash payment of $875,000. Agreement was also reached on a ceiling of $375,000 for the implementation program at loan staff rates. Whittaker executed and delivered to Arthur Andersen a written release of its claim in consideration of the payment to it of $875,000.

According to Whittaker, immediately preceding agreement to the terms of this final proposal, Arthur Andersen inquired of Whittaker whether Arthur Andersen would be recommended to the shareholders at the forthcoming shareholders meeting and were told they would be recommended.

According to Whittaker, Arthur Andersen desired to have disclosures concerning the settlement limited to the $875,000 cash payment.4/ According to Arthur Andersen the settlement amounted only to the cash payment of $875,000 and, since the other factors were not a part of the settlement, no disclosure was necessary.

Following the settlement, counsel for Whittaker requested a meeting with the staff of the Commission, including the Chief Accountant of the Commission, in order to discuss the possible effect the settlement might have on Arthur Andersen's independence. This meeting took place February 6, 1973 and was attended by senior management of Whittaker and senior partners of Arthur Andersen, including on both sides persons who had attended the negotiating meetings described above, and by their respective counsel. At that time, the $875,000 cash payment settlement was described to the Commission as the settlement. No mention was made of the earlier free review work that Arthur Andersen had performed several months before any threat of suit (which had been estimated to have involved almost $1 million if billed at normal rates), and no mention was made of the additional agreement by Arthur Andersen to assist in implementing the review recommendations at loan staff rates up to an amount of $375,000. In addition, no mention was made of the deficiencies in the Crown audit even though the Commission staff, concerned because of the apparent size of the settlement, asked Arthur Andersen representatives whether there were significant audit deficiencies. Arthur Andersen personnel at the meeting stated that they stood by the quality of their audit and were making a settlement solely to avoid protracted litigation. As a result of that meeting, the staff of the Commission concluded, considering all of the circumstances then known to it, that it would not challenge Arthur Andersen's independence.

Following the meeting with the staff, Whittaker recommended to its shareholders in a proxy statement dated February 16, 1973 that Arthur

Andersen be selected as Whittaker's auditors for the fiscal year 1973. At the annual meeting of shareholders held on March 20, 1973, the shareholders approved management's recommendation.

Shortly thereafter, the Commission learned of the fee arrangements between Whittaker and Arthur Andersen with respect to review work and implementation. As a result of this, it ordered that a formal investigation be undertaken into this matter. As noted supra, as a result of that investigation, the Commission on February 8, 1974 instituted an injunctive proceeding against Whittaker,5/ and ordered the institution of these proceedings. In the injunctive action, the Commission charged Whittaker with violating Section 14(a) of the Securities Exchange Act of 1934 and Rule 14a-9 thereunder in connection with Whittaker's February 16, 1973 proxy statement in which Whittaker sought shareholder ratification of the appointment of Arthur Andersen as Whittaker's auditors for the fiscal year 1973.6/ Contemporaneous with the filing of the complaint, Whittaker, without admitting or denying the allegations contained therein, consented to the entry of an order enjoining Whittaker from future violations of Section 14(a) of the Securities Exchange Act and Rule 14a-9 thereunder. Whittaker also consented to the entry of an order requiring it to disclose to its shareholders in the first proxy solicitation made by Whittaker following the entry of the court's decree, "the full details of its relationship with Arthur Andersen & Co." On March 26, 1974, Whittaker mailed to its shareholders a proxy statement setting forth its relationship with Arthur Andersen.

In many respects, Arthur Andersen must share responsibility for the incomplete disclosure contained in Whittaker's 1973 proxy statement. Arthur Anderson must also share responsibility for the incomplete statement that was given to the staff of the Commission when the staff's advice was sought concerning Arthur Andersen's continued independence.

Anything less than full disclosure cannot be considered consistent with the securities laws. The keystone of the securities laws is disclosure, disclosure which puts a premium on two objectives:

> "The emphasis on disclosure rests on two considerations. One related to the proper function of the federal government to investment matters. Apart from the prevention of fraud and manipulation, the draftsmen of the '33 and '34 Acts viewed that responsibility as being primarily one of seeing to it that investors and speculators had access to enough information to enable them to arrive at their own rational decisions. The other rests on the belief that appropriate publicity tends to deter questionable practices and to elevate standards of public conduct."7/

The ultimate goal of the securities laws is, of course, shareholder and investor protection. Effective disclosure is essentially a means to that

end and the entire legislative scheme can be frustrated by technical or formalistic attempts to comply with the statutes and rules involved without complying with the substance and hence the spirit and purpose of the laws involved. The Commission has consistently attempted to achieve disclosure in terms which are "clearly understandable."8/ Unfortunately, actual disclosures made have not always achieved the objectives of the statute. As District Judge Weinstein noted in this connection:

> "In at least some instances, what has developed in lieu of the open disclosure envisioned by the Congress is a literary art form calculated to communicate as little of the essential information as possible while exuding an air of total candor. Masters of this medium utilized turgid prose to enshroud the occasional critical revelation in a morass of dull, and -- to all but the sophisticates -- useless financial and historical data. In the face of such obfuscatory tactics the common or even the moderately well informed investor is almost as much at the mercy of the issuer as was his pre-SEC parent."9/

In the instant case both Whittaker and Arthur Andersen, in seeking the advice of the Commission's staff in the manner in which they did, not only frustrated the purposes of the statute but imposed upon the Commission and its staff by seeking advice without providing the staff with all of the material facts. The representatives of Arthur Andersen in this regard emphasize that they were acting in good faith and in reliance on advice of several counsel, and that they believed additional disclosure was not germane or required. It should be apparent to all, however, that the securities laws and their administration by the Commission and its staff cannot function well if those who practice before the Commission and those who file documents with it fail to operate in an atmosphere of unquestionable candor and full disclosure. Adequate disclosure does not take place when there are salient facts bearing on the merits of a negotiated settlement which are not disclosed.

Whatever the merits of the argument that disclosure of the other aspect of the settlement were not required to be made in the proxy statement, there is no excuse for their non-disclosure to the staff of the Commission when its advice was being sought. The advice sought and the advice given are only as good as the information upon which they are predicated. The limited review engaged in by the staff of the Commission, whether it relates to registration statements, proxy statements or other materials filed with the Commission, and the advice sought and the comments given by the staff cannot take place consistent with the objectives of the statutes in an adversarial atmosphere. The Commission and its staff do not and cannot investigate representations made to it, but must be able to rely on their completeness if this process is to work. The objectives of the securities laws can only be achieved when those professionals who practice before the Commission, both lawyers and accountants, act in a

manner consistent with their responsibilities. Professionals involved in the disclosure process are in a very real sense representatives of the investing public served by the Commission, and, as a result, their dealings with the Commission and its staff must be permeated with candor and full disclosure. It cannot resemble an adversary relationship more appropriate to litigants in court, because the Commission is not an adverse party in this context. All who are familiar with the Commission's policies know that too much importance is attached to the word of the professional, to permit his or her word to become the subject of question. A professional's word is often the functional equivalent of his or her reputation. Conferences with the staff of the Commission serve a vital role in the administration of the securities laws, and such conferences are predicated, for the most part, upon full disclosure by the professionals involved. It must be understood by all who practice before the Commission, lawyers and accountants alike, that the Commission and its staff cannot tolerate less than full disclosure.

By the Commission, Commissioner Sommer not participating.

George A. Fitzsimmons
Secretary

1/ Employees at Crown improperly prepared and/or recorded production and other accounting records so that the overall book inventory was virtually equal to the inflated physical accounts.

2/ An Arthur Andersen internal memorandum dated March 14, 1970, expressed the following:

> ". . . There may be a question as to this client's [Crown] credibility as their position changes relative to the net income they wish to report and the pressures Whittaker is exerting on them.
>
> * * * * *
>
> "In our opinion, the Crown personnel have not been kept fully informed by Whittaker on just what we are doing in

2/ (continued)

> relation to the S-1. It is their opinion that we should pass adjustments so they can show a very favorable trend. They have told us that this is what our other offices are doing, and that you have agreed that our treatment of the inventory and bad debt adjustments is not valid - they are definitely trying to play off you against us to get favorable treatment."

3/ At a board of directors meeting in early December, the topic of submitting the name of Arthur Andersen to the shareholders for ratification as the auditors for the following year was discussed even though Whittaker had not previously submitted to their shareholders the question of ratifying the selection of auditors. At a board meeting held on December 22, 1972, it was decided that Arthur Andersen would be recommended to the shareholders, provided that the claim Whittaker intended to assert against Arthur Andersen could be resolved. However, when Arthur Andersen requested a copy of the minutes in connection with its audit, Whittaker furnished only a summary of the minutes of this meeting, claiming that the full minutes had not as yet been prepared. The summary made no mention of the claim against Arthur Andersen.

4/ The disclosure of the settlement in Whittaker's proxy material dated February 16, 1973, was as follows:

> "Arthur Andersen & Co. has acted as the Company's independent auditors since 1952. Upon discovery in May, 1972 that the book inventory at one of the company's subsidiaries exceeded the physical inventory by approximately $6,300,000, Arthur Andersen & Co. undertook a detailed review of the accounting and financial controls at each of the Company's operating units and developed recommendations for the improvement of such controls. These recommendations have been reviewed by the Company and are being implemented by the Company with the assistance of Arthur Andersen & Co. Arthur Andersen & Co. has agreed to pay the Company $875,000 as reimbursement for certain expenses of the Company related to the inventory discrepancy, and the Company has agreed that it will not initiate against Arthur Andersen & Co. any claims it might have as a result of the inventory discrepancy. The agreement preserves all of the Company's other rights relating to the inventory discrepancy, including its right to prosecute its full claim against its fidelity insurance carriers."

5/ <u>Securities and Exchange Commission</u> v. <u>Whittaker Corporation</u>, C.D. Calif., C.V. 74 345 HP (filed February 8, 1974).

6/ In September 1973, during the pendency of the Commission's investigation which preceded the filing of the above-mentioned complaint, Whittaker's board of directors concluded that the interests of the company required the appointment of a successor to Arthur Andersen as the company's auditor so that the fiscal 1973 financial statements could be audited on a timely basis. Whittaker concluded that in the context of that investigation, "Arthur Andersen & Co. would be disabled from rendering an opinion with respect to the company's financial statements for the 1973 year."

7/ See F. Wheat, Disclosure to Investors, 10 (1969) (hereinafter referred to as the "Wheat Report").

8/ Wheat Report, at 78.

9/ Feit v. Leasco Data Processing Equipment Corp., 332 F.Supp 544, 565 (E.D.N.Y., 1971).

ORDER

Under the terms of its offer of settlement, Respondent without admitting or denying the Commission's findings and only for the purpose of settlement, consented to the entry of an order embodying the following sanctions.

Accordingly, it is ORDERED that, subject to the terms and conditions provided in the offer of settlement, Respondent is censured by the Commission.

By the Commission, Commissioner Sommer not participating.

George A. Fitzsimmons
Secretary

From the Wall Street Journal, Oct. 12, 1975

Arthur Andersen Generally Is Praised In 'Public Review' Board's First Report

By Frederick Andrews
Staff Reporter of The Wall Street Journal

NEW YORK—The blue-ribbon "public review" board appointed last year by Arthur Andersen & Co. made public its first report on the huge accounting firm's operations.

Praising the firm's "strong commitment to excellence," the five-man review panel also urged Andersen to spruce up its tax practice; apply its audit skills to political campaign financing, and strongly consider hiring another accounting firm to audit Andersen's financial results. The review panel also had some approving words for class-action lawsuits, which accountants often seem to consider a form of legalized blackmail.

The public-review board's 26-page, generally laudatory report was published as part of Arthur Andersen's annual report for fiscal 1975, ended Aug. 31. In that document, the firm's third annual report, Andersen expanded its disclosures to include a full set of financial statements, which it described as equivalent to an external audit, except for being performed by an Andersen team. Andersen also included a summary of its financial results adjusted for the impact of inflation.

Peat Marwick's Method

A year or so ago, in hopes of inspiring public confidence in public accounting, both Andersen and its rival, Peat, Marwick, Mitchell & Co., the nation's two largest CPA firms, offered to open their files and inner workings to outside scrutiny. The two firms chose different methods, however.

Peat Marwick invited an inspection team from the accounting profession, and when that effort bogged down in competitive fears, Peat Marwick hired Arthur Young & Co., another national firm, to do a "quality review." Arthur Young's report is expected soon.

Andersen chose instead a panel of prominent outsiders, naming as chairman Newton N. Minow, former chairman of the Federal Communications Commission and currently a Chicago lawyer. Other panel members are William L. Cary, a law professor and former chairman of the Securities and Exchange Commission; James Don Edwards, a prominent accounting professor; George Romney, a former Cabinet member, and Randolph W. Thrower, former commissioner of internal revenue and currently an Atlanta lawyer.

In an interview, Mr. Minow said the review panel met as a group six times, totaling 10 days. In all, Mr. Minow logged 311 hours in his work as chairman, he said. Prof. Edwards said he put 45 days into the panel's activities. The panel members are paid $20,000 a year.

In making its review, the board said it talked at length with Andersen partners, checked its written procedures and controls, visitied 13 Andersen offices and talked with accounting authorities and other firms. For field work, the panel relied mainly on monitoring Andersen's own audit-review program, which the panel called "a searching inquiry . . . conscientiously and competently carried out." It involves audit partners from other offices visiting Andersen's 103 offices at least once every three years and inspecting audit work. (Other firms have similar procedures.)

Findings and Conclusions

The public review panel generally gave the Andersen firm high marks on its ethics, independence, performance and integrity. Among the panel's findings and conclusions were:

The firm should retain a financial analyst as an adviser to keep it up to date on what information security analysts and other users need in financial statements.

—Partners should rely less on staff accountants and assume a larger role in detailed audit work and, in particular, in the firm's tax work. While Andersen's tax division is "consistently of a high quality," its junior tax accountants need better training and supervision.

Andersen should volunteer its services without charge to help the Federal Elections Commission develop accounting standards and ways to monitor political financing. (Andersen is doing this, and it also has become the auditor for both the Democratic and Republican national committees, the panel said.)

—Currently, 33 civil lawsuits are pending against Andersen over past audit work, but the firm hasn't had a malpractice suit decided against it. Suits have been dismissed, settled for what the review panel considers small sums or remain pending. (Of 13 lawsuits resolved in 1975, six ended with favorable court rulings, and seven were settled for a total of $330,000. The firm also spent $2.5 million on legal fees and expenses.)

"On balance, despite the costs involved, private lawsuits do encourage attentiveness and care in the conduct of audits and needed disclosures in financial statements," the panel concluded.

Andersen remains the only accounting firm to disclose its profit or detailed revenue figures, though the financial summaries it issued for 1973 and 1974 have drawn criticism as ambiguous. Partly at the review panel's urging, for fiscal 1975, the firm published financial statements comparable to those required of publicly held companies.

For 1975, Andersen's fee revenue was up 16% to $386.3 million from $332.8 million a year earlier. The growth was attributed to a 1.5% growth in hours of client work and to higher fees. (Fees were raised 8.5% in the U.S. and 14.7% abroad.) The firm's five largest clients account for 6.6% of its fee revenue. In the U.S., Andersen's rates range from $15 an hour for novice staff members to $154 an hour for special consulting by partners.

Andersen's earnings for 1975 rose 14.1% to $90.8 million from $79.6 million for 1974. Earnings per active partner were up 5.1% to $95,152 (based on 844 partners) from $90,550 a year earlier (based on 814 partners). Those figures aren't comparable to corporate net income, Andersen said, because they include both partners' pay and return on partners' capital. Also, Andersen partners' pay for their own fringe benefits. Total partners' capital rose to $100.6 million from $93.1 million. No partner has a stake larger than 0.5% in earnings or capital.

Separately, Andersen refigured its financial results in terms of Aug. 31, 1975, dollars, following the Financial Accounting Standards Board's pending proposal for inflation accounting.

By that yardstick, the firm's revenue rose only 5% to $398.8 million, and its earnings rose only 5.3% to 86.8 million. Adjusted for inflation, earnings per partner dropped 3% to $90.9 million from $93.8 million.

The inflation adjustments resulted in a $6 million charge against 1975 earnings from holding more monetary assets—mainly $97.8 million in receivables—than monetary liabilities. The comparable charge for 1974 was $7.6 million.

(From the New York Times, March 10, 1976)

DATA LAXITY LAID TO MERCK AUDITOR

Andersen & Co. Is Said to Have Failed to Follow Up on Illegal Payments

By ROBERT D. HERSHEY Jr.
Special to The New York Times

WASHINGTON, March 9—The outside auditor for Merck & Company failed to follow up information it was given about questionable foreign payments despite knowledge that in at least one case the payments were illegal, according to company documents made available today at the Securities and Exchange Commission.

The auditor, Arthur Andersen & Company, has nonetheless been endorsed by the Merck board to continue examining Merck's books.

These disclosures were made by a special committee appointed by the company and charged with investigating Merck's previously reported payments to foreign governments and agencies, which totaled $3.6 million during the 1968-75 period.

The committee report also said that in at least two instances Henry W. Gadsden, chairman and chief executiv officer of Merck, ignored "possible warning signals" of impropriety.

Merck, a huge drug company based in New Jersey, also disclosed that part of the overseas payments had been "mistakenly" deducted from Federal income tax returns for years prior to 1974. The Internal Revenue Service, it also said, is exploring the possibility of conducting its own investigation for possible tax fraud.

In a policy statement, Merck said it would no longer make any payments to any government officials or agent to promote sales of its products and that it would no longer contribute to any political campaign at any level in the United States.

Meanwhile, the American Home Products Corporation, a producer of non-prescription medicines and food products, told the S.E.C. that political contributions were made outside the United States in four countries. In two cases, they were of uncertain legality and in a third no opinion has been sought "because of its present political instability."

ARTHUR ANDERSEN & CO.

Briefs

Vol. 4, No. 10 June, 1976

OUR FIRM FILES PETITION WITH SEC

Request for Action With Respect to Certain Rules and Pronouncements Relating to Accounting Principles

Our firm has become increasingly concerned about developments in recent years at the Securities and Exchange Commission with respect to accounting standards, principles, and practices, as they relate both to registrants and to independent auditors. While professing to cooperate with the private sector in achieving improvements in accounting principles and financial reporting, the Commission and its staff have created not only a sense of serious concern about the objectives of the Commission but also considerable uncertainty. The recent rule of the Commission with respect to "preferability" of accounting principles has highlighted this concern.

We concluded that the only responsible course of action for our firm to follow was to file a petition with the Commission for the purpose of trying to clarify certain aspects of the present situation.

Our objective is to sort out the relative responsibilities and rights of registrants, independent auditors, and professional organizations as well as the Commission so that the ground rules are properly determined and understood rather than being in such a state of confusion. We believe that this involves the Commission going back to "square one" of three years ago and starting on a meaningful, effective, and coordinated program to work with the accounting profession and the business community in achieving solid progress in the area of accounting principles for the benefit of investors and the other users of financial statements.

The matters covered in our petition filed on June 15, 1976, are discussed briefly below. Copies of the petition are available upon request at any of our offices.

Questions Regarding What Accounting Principles Are Acceptable to the SEC

The basic rule in Regulation S-X with respect to the report of the independent auditor states that such report should clearly give the opinion of the auditor "in respect of the financial statements covered by the report and the accounting principles and practices reflected therein," without indicating how or by whom the accounting principles and practices are to be determined.

Accounting Series Release No. 150 (ASR 150) issued by the SEC in 1973 reaffirmed a previous rule issued in 1938 that financial statements prepared in accordance with accounting practices for which there is no "substantial authoritative support" are presumed to be misleading. ASR 150 states as a new rule that accounting standards, principles, and practices promulgated by Statements and Interpretations of the Financial Accounting Standards Board (FASB), the Opinions of the Accounting Principles Board (APB), and the Accounting Research Bulletins of the Committee on Accounting Procedure that are still in effect will be considered by the Commission as having "substantial authoritative support."

Whatever meaning the undefined term "substantial authoritative support" may have had originally when used by the Commission in 1938, such meaning would be vastly different today. The Committee on Accounting Procedure, the predecessor to the APB and the FASB, issued its first pronouncement in 1939, and many developments concerning accounting principles have occurred since that time. A subcommittee of the Accounting Principles Board worked diligently on a definition of that term. However, the project was abandoned more than three years prior to the time that ASR 150 was issued because the conclusion was reached by the APB that the term could not be defined in a meaningful manner. Since the Commission and its staff continue to use that term to mean whatever they want it to mean, it is now particularly urgent that the term be defined or abandoned.

While registrants and their auditors *may* follow the 700 pages of designated professional pronouncements (issued from 1939 to 1973) and be reasonably confident that they will satisfy the "authoritative support test," ASR 150 also states that any standards, principles, and practices contrary to such pronouncements are considered to be misleading under the Securities Acts. Any departures in unusual circumstances are to be handled on an *ad hoc* basis which would not have the status or protection of a rule. This requirement represents the most significant and sweeping rule relating to accounting principles ever issued by the Commission.

There is a vast difference between (a) independent auditors voluntarily following professional pronouncements and (b) independent auditors being required to follow such pronouncements by a rule of the Commission. The Commission in issuing ASR 150 not only failed to follow the rule-making procedure (including public exposure for comment) prescribed by the Administrative Procedure Act but also followed the highly questionable procedure of adopting, as a part of a current rule, all future pronouncements of the FASB. As a result, ASR 150 appears to have been adopted contrary to law.

Fairness of Presentation of Financial Statements

The Commission and its staff have emphasized on numerous occasions in recent years the proposition that independent auditors, in giving opinions on financial statements, have a responsibility to use their professional judgment with respect to what "fairly presents" the financial position and results of operations, undeterred by the rigidities of generally accepted accounting principles. The comments associated with the SEC in this regard are along the lines of: (1) "present fairly" cannot be defined by simple reference to generally accepted accounting principles; (2) "fairness" is related in some fashion to "truth" that has a meaning beyond generally accepted accounting principles; (3) determining "fairness" of financial statements represents an opportunity to move away from the rigidities of generally accepted accounting principles and other deterrents; and (4) independent auditors can and should make judgments of "fairness." The Commission has not indicated how these more nebulous views relate to the strict interpretations currently imposed upon registrants and their auditors under ASR 150 by the Commission and its staff. In many cases, the Commission and its staff will not permit the registrants and their auditors to do what they believe is necessary to achieve "fairness."

Our firm has advocated the idea of "fairness" with respect to financial statements for many years. In fact, we published a booklet on that specific subject in 1960. However, an important distinction exists between "fairness" as advocated by our firm and as advocated by the Commission. Our firm has viewed "fairness" as a base point for the determination of sound and uniform standards and principles to be applied in an objective manner. On the other hand, the Commission seems to view "fairness" as something to be applied by each independent auditor on each engagement in a subjective manner without any criteria.

We are for the idea of "fairness" as much as anyone, but we doubt that a broad approach on the subjective basis as advocated by the Commission is feasible or desirable at the present time. In any event, the Commission cannot reasonably expect registrants and auditors to achieve "fairness" while they are being legally tied by the Commission to voluminous professional literature (some of which is out of date) and to other technical rules in the minds of the Commission and the staff that apparently fall under the undefined term "substantial authoritative support." In other words, the Commission on the one hand is asking registrants and auditors to do what the Commission on the other hand will not let them do.

New Commission Rule

ASR 177. The Commission, in Accounting Series Release No. 177 (ASR 177), dated September 10, 1975, adopted a far-reaching and significant rule amending Instruction H(f) of Form 10-Q, effective for reports covering periods beginning after December 25, 1975.

The Commission by this rule added a new, undesirable, and apparently unlawful requirement when it stated that with respect to an accounting change "a letter from the registrant's independent accountants shall be filed as an exhibit indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances. . . ." ASR 177 states that the Commission "believes that professional accounting judgment can be applied to determine whether an alternative accounting principle is preferable" and that the justification should be "sufficiently persuasive to convince an independent professional accounting expert that in his judgment the new method represents an improved method of measuring business operations. . . ." Thus, judgments with respect to preferability of accounting principles, which are binding on their clients (and affect even those clients not seeking a change in accounting principles), are to be made by individual auditing firms, and such judgments could be completely different from those of other auditing firms. These judgments are to be made even for matters on which authoritative professional bodies have been unable, over many years, to reach a consensus as to the preferable principles from among alternatives.

"The Accounting Model." The Auditing Standards Executive Committee of the AICPA requested that the Commission reconsider Instruction H(f) of Form 10-Q, as adopted by ASR 177, but the Commission in a letter dated April 30, 1976, stated that it found no reason to change that Instruction. That letter includes the following:

> ". . . One of the fundamental professional responsibilities of an independent accountant is to apply his skills and trained judgment in economic measurement to particular factual cir-

cumstances to determine whether the circumstances are fairly accounted for within the framework of the accounting model.

"The Commission believes that the independent accountant must exercise professional judgment in appraising the accounting principles used by his client in reporting economic results. In effect, he must share the responsibility for assuring that operations are described in a fashion which will be meaningful to investors for purposes of their decision making, subject to the limitations of the basic accounting model. The Commission believes that the concept of 'fair presentation' embodies this responsibility."

The only limitation in accomplishing the stated objectives is "the accounting model." We do not know what is meant by "the accounting model." There is no common understanding of its meaning, and it has not been defined by the Commission or any authoritative professional body. If the notion of "the accounting model" is to play a significant role in "preferability" determinations, it is incumbent on the Commission to prescribe the specific parameters and elements of this model.

Compliance With Rule. As if enough confusion did not exist as a result of the rule itself, the application of the rule is creating additional confusion.

AICPA Statement on Auditing Standards No. 1 (in interpreting a provision of APB Opinion No. 20) requires independent auditors to satisfy themselves that "management's justification for the change is reasonable" after considering the circumstances, and this has been the standard. The Commission has stated that it does not accept this standard and that it believes the twenty-one members of the AICPA Committee in unanimously adopting this provision "has amended an accounting standard in an inappropriate way." In our view, the Commission has imposed its judgment and amended both an accounting standard (APB Opinion No. 20) and an auditing standard (SAS No. 1) in an inappropriate way.

The Commission has discarded the test of "reasonability" for independent auditors in favor of one of "preferability," which is a major change. This is further illustrated in SEC Staff Accounting Bulletin No. 6 which states, with respect to areas of accounting such as FIFO and LIFO inventory costing methods, that the staff would not expect, except under substantially different circumstances, an accounting firm to accept accounting changes in both directions by different clients.

We submit that there are important areas of accounting, such as those involving FIFO and LIFO, where differences in accounting principles simply cannot be justified by differences in circumstances in individual cases. These are the areas where the Accounting Principles Board and the Financial Accounting Standards Board have spent most of their time, and much remains to be done.

Independent auditors could possibly attempt to "buy time" by relying extensively on "in the circumstances"— hoping that somehow the problem will go away. In our view, such an approach represents only a "time bomb" that will explode at some future date. For independent auditors to comply ostensibly with the Commission's requirement by obtuse wording of their opinions on preferability of accounting principles or by taking evasive positions in such opinions would only lead to a loss of credibility of the audit function and severe criticism in the future. Our firm desires to deal with the important subject of preferable accounting principles in a forthright and straightforward manner.

If the Commission has decided that new steps should be taken to eliminate accounting alternatives, an overall coordinated program is necessary rather than requiring each auditing firm to decide which alternatives are preferable where accounting changes are sought.

Position of Our Firm Under Present Rules

The Commission has statutory authority to establish appropriate rules with respect to accounting principles and practices. However, the Commission also has a responsibility to adopt rules that are in conformity with law and that are clear and not inconsistent with other rules of the Commission; nor should pronouncements, comments, and actions of the Commission and its staff be inconsistent with its rules.

Our firm is willing to make appropriate professional judgments. However, because of the inconsistent and questionable positions as well as the apparently illegal actions taken by the Commission, as set forth in our petition, our firm is placed in an untenable position in trying to carry out its responsibilities under the Securities Acts and under the rules of the Commission.

We have a grave responsibility to be fair to all of our clients. Whenever our firm, which has played an active role in the determination and formulation of accounting principles and in advocating improvements, states publicly that an accounting principle or practice is preferable, we are also indicating that any alternative principles or practices to that one are not preferable. A letter from our firm (filed by a client with the SEC as part of Form 10-Q) stating that a particular principle is preferable could adversely affect many other clients not involved in such a decision and could adversely affect the reputation

and credibility not only of such other clients in issuing financial statements but also of our firm in giving reports on the financial statements of such clients, whether or not they ever make accounting changes. Thus, our clients could be affected without their knowledge at the time, and our clients and our firm could be subjected to costly litigation.

A determination of the preferability of an accounting principle among alternatives cannot be limited to the time that an accounting change occurs. If a particular principle is preferable when a change is made, why is it not equally preferable even though no change is made or contemplated? Further, decisions as to preferability cannot be made by our firm on an *ad hoc*, isolated, and uncoordinated basis. Also, we cannot make these decisions without considering their effect on all of our clients.

We have procedures that can be used, if necessary, for making the decisions required by the recent actions of the Commission. However, these decisions can be made only if they are based on our own carefully considered views concerning the objectives of financial statements and an appropriate conceptual framework. A conceptual framework for arriving at "fairness" and "preferability" of accounting standards, principles, and practices does not exist with respect to the current concept of "generally accepted accounting principles," and this condition is documented by APB Statement No. 4. Thus, the decisions the Commission is asking our firm to make cannot possibly be resolved by reference to those accounting principles that are being permitted by the Commission under the rules in ASR 150.

If we are required to make these decisions under SEC rules, we can do so. Our procedures contemplate obtaining the views of our clients and notifying them of our decisions, just as the FASB or the Commission would do, granting to them a form of "due process" so that their views can be considered before they are affected by decisions made by our firm. This procedure would involve the issuance of discussion memoranda on conceptual matters and specific areas of accounting and the exposure of drafts of our conclusions for comment. Our conclusions would be published so that our clients and the users of the financial statements of our clients would know our conclusions and the basis and reasoning for arriving at them.

In cases of differences in views on preferable accounting either between our firm and our clients or between our firm and other auditing firms (which are certain to arise), the Commission should anticipate that it would be required to resolve the differences of viewpoints and make formal decisions on preferable accounting principles and practices if a coordinated and consistent approach is to be achieved. Thus, the Commission has taken a step that could have serious repercussions on the FASB, while at the same time professing to support the FASB.

What Needs to Be Done?

If improvements are to be made in accounting principles, the solution is to eliminate undesirable principles and to adopt desirable principles on a coordinated basis and under a sound conceptual framework. The solution should not involve reliance on indirect attempts to stop certain business enterprises from adopting accounting principles that are being followed by a great many other business enterprises, because to do so is unreasonable discrimination. Nor should the solution put the Commission in the position of evading its own responsibilities.

We have reached the conclusion that we have no alternative but to request reconsideration and clarification of the matters set forth in our petition. Therefore, we have requested the Commission:

1. To revoke amended Instruction H(f) of Form 10-Q and the related explanatory paragraph, as adopted and included in ASR 177.
2. To revoke ASR 150.
3. To define, through the rule-making procedures prescribed by the Administrative Procedure Act, the current meaning of the term "substantial authoritative support" as that term is used in ASR 4 and as it relates to the accounting standards, principles, and practices of registrants when independent auditors give opinions on the financial statements of registrants filed with the Commission under the Securities Acts; or, if the Commission prefers not to define that term, to revoke ASR 4.

ARTHUR ANDERSEN & CO.

Briefs

Vol. 4, No. 11 June, 1976

REACTION IN THE ACCOUNTING PROFESSION TO OUR SEC PETITION SHOWS LACK OF UNDERSTANDING OF ITS INTENT AND THE ISSUES INVOLVED

As discussed in the last issue of the *Executive News Briefs* (Vol. 4, No. 10), our firm has filed a petition with the Securities and Exchange Commission requesting action with respect to certain rules and pronouncements relating to accounting principles. We believe that it would be informative and revealing to analyze some of the public statements that have been made about our petition.

Our petition is not a fundamental and broadside attack on the standard-setting mechanism in the private sector (the FASB) as alleged by the Chief Accountant of the SEC and reiterated by some of our associates in the accounting profession. If the FASB is adversely affected, this will not be a result of our petition but rather the effect of the actions already taken by the SEC. We are firmly convinced that the positions we have taken in our petition are in the best interests of the business community and investors as well as the accounting profession.

Comments by Others

The following comments of the Chief Accountant of the SEC about our petition were quoted in *The Wall Street Journal* (June 22, 1976):

> "In rebuttal, Mr. Burton charged the Andersen firm with launching 'a fundamental attack on the whole standard-setting mechanism as it now exists.' In a telephone interview from Washington, the SEC chief accountant said, 'It's unfortunate that Arthur Andersen has chosen to attack the concept of standard-setting in the private sector. This is a broadside attack on this (SEC) policy and also a broadside attack on the (standards board). I'm sorry to see a major accounting firm in this posture.' "

An article in *The Wall Street Journal* (June 24, 1976) quoted several persons criticizing our firm along the same general lines as the Chief Accountant of the SEC. This article contained in part the following:

1. "In an interview, Marshall S. Armstrong, standards board chairman, predicted that his institution couldn't survive if the Andersen challenge prevailed." Later in the article, Mr. Armstrong is quoted as saying: "To have our standards standing in competition with other standards —in the same set of circumstances—I don't think the board could survive. . . ."

2. A representative of one auditing firm said: "We vigorously oppose any actions which would hand this function over to the government."

3. Representatives of three other auditing firms all reiterated in different words the view expressed by one of them that our position "would effectively place accounting rule-making in the hands of the SEC."

These statements raise three significant issues, apart from the legal matters covered in our petition, and these are discussed below.

Support of the FASB by Our Firm

Our firm has fully supported the concept of the Financial Accounting Standards Board and continues to do so at the present time. No criticism of the FASB is in our petition, and, contrary to the above comments, we do not believe that anything in our petition is detrimental to the FASB. In fact, we believe that what we are requesting in our petition is essential to the preservation of the FASB. While we have been disappointed with the progress and leadership of the FASB, that viewpoint is not reflected in, and has no bearing on, our petition to the SEC.

Does the FASB Need Support of the Securities Acts to Survive?

Our firm is opposed to SEC rule-making in the area of accounting principles. We are firmly opposed to a "cookbook" and legalistic approach to accounting principles.

The Chairman of the FASB and others are saying that the FASB cannot survive if our petition prevails. Our view is that the FASB cannot survive

unless our petition does prevail. Therefore, some basic differences of viewpoint obviously exist. They apparently believe that the rule in Accounting Series Release No. 150 (ASR 150) to which we specifically object is essential to the success of the FASB. This rule, which appears to have been adopted contrary to law and which we believe should be revoked, in effect provides that 700 pages of technical pronouncements issued by the FASB and the two predecessor organizations from 1939 to 1973, *as well as all future pronouncements,* must be followed or the accounting will be presumed to be *misleading* under the Securities Acts. This requirement represents the most significant and sweeping rule relating to accounting principles ever issued by the SEC.

There is a vast difference between (a) independent auditors following professional pronouncements, as was done for many years prior to ASR 150 and (b) independent auditors being required to follow such pronouncements by a rule of the SEC. We are not suggesting that the FASB pronouncements should be adopted as SEC rules; in fact, we are objecting to their adoption as SEC rules.

Our position is consistent with that of the Wheat Committee, which established the plan for the FASB, when it wisely decided that the FASB should not seek the formal support of the Securities Acts for its pronouncements because this would inevitably lead to more and more governmental rule-making and intervention. If the survival of the FASB, as suggested by some of the comments about our petition, is dependent on the legal support of the Securities Acts, along with the SEC intervention that inevitably follows, this is an ominous sign for the entire business community and raises a question about the viability of the FASB as a standard-setting mechanism in the private sector.

Will the SEC Rule on "Preferability" of Accounting Principles Effectively Destroy the FASB?

As we indicated in the last issue of the *Executive News Briefs,* the SEC has adopted a new rule with respect to changes made by registrants in accounting principles requiring that "a letter from the registrant's independent accountants shall be filed as an exhibit indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances. . . ." Thus, judgments with respect to preferability of accounting principles, which are binding on their clients (and affect even those clients not seeking a change in accounting principles), are to be made by individual auditing firms, and such judgments could be completely different from those of other auditing firms. These judgments are to be made even for matters on which authoritative professional bodies have been unable, over many years, to reach a consensus as to the preferable principles from among alternatives.

Since a burden is placed on each auditing firm to determine "preferable" accounting principles in all areas where alternatives do or could exist, these determinations affect all of its clients whether or not they are making accounting changes. Different decisions as to "preferability" are going to be made by various auditing firms, and the result will be either chaos or SEC intervention to impose what it considers to be preferable in each area of accounting.

These "preferability" determinations would have to be done on a coordinated basis within each auditing firm, supported by the objectives and conceptual framework established by each firm. Any attempt to make these determinations within the existing accounting rules as presently mandated by the SEC under the Securities Acts in ASR 150 is doomed to failure. If either the FASB or the SEC were to determine "preferable" accounting principles, we submit that they could not do so within the confines of the present rules.

Each auditing firm will assume a greater role in determining its own "preferable" accounting principles. Regardless of what other auditing firms may do, our firm does not intend to make unilateral determinations of "preferable" accounting principles that can have a significant effect on all of our clients without giving our clients the opportunity to express themselves under prescribed procedures before we make our decisions, just as the FASB or SEC would do.

The effect of this new requirement will be for the arena of establishing accounting principles to move from the FASB to the auditing firms and then to the SEC. The "umpiring" between auditing firms and, perhaps, between registrants and their auditing firms will have to be done by the SEC because the FASB cannot perform that function. Thus, the new SEC requirement can only result in adversely affecting the FASB as well as everyone else involved, and we are trying to eliminate that requirement.

Arthur Andersen Raises Scathing Protest To the SEC's Policy on Accounting Rules

THE WALL STREET JOURNAL, Tuesday, June 22, 1976 11

By FREDERICK ANDREWS
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—In a scathing protest, Arthur Andersen & Co., the large Chicago-based accounting firm, has challenged the Securities and Exchange Commission's fundamental policy toward the setting of accounting rules for publicly traded companies.

In a petition filed with the SEC, the outspoken Andersen firm disputes the entire thrust of the agency's recent accounting positions. Andersen contests the SEC's right to delegate blanket authority on accounting to the Financial Accounting Standards Board, the private sector's top standard-setting body, or to require that companies and auditors observe the standards board's rules as the only acceptable accounting under federal securities laws.

Though highly technical, the 15-page Andersen petition amounts to the firm's dropping a gauntlet before the SEC and its aggressive chief accountant, John C. Burton. Mr. Burton, who has been in office four years, is "generally acknowledged to have brought about far-reaching and highly controversial changes in accounting, auditing, and financial disclosure.

The Andersen petition described various SEC pronouncements as nebulous, ambiguous, contradictory, unreasonable, arbitrary, capricious and contrary to law. It urged the agency to "sort out the relative responsibilities and rights" of companies, auditors, and professional bodies such as the standards board. "This involves the commission going back to square one of three years ago," Andersen said.

In rebuttal, Mr. Burton charged the Andersen firm with "launching a fundamental attack on the whole standard-setting mechanism as it now exists." In a telephone interview from Washington, the SEC chief accountant said: "It's unfortunate that Arthur Andersen has chosen to attack the concept of standard-setting in the private sector. This is a broadside attack on this (SEC) policy and also a broadside attack on the (standards board). I'm sorry to see a major accounting firm in this posture."

Specifically, the Andersen petition urges the SEC:

—To revoke Accounting Series Release No. 150, the December 1973 pronouncement generally regarded as the ultimate source of the standards board's authority.

—To revoke a controversial position adopted last September requiring auditors to express an opinion on whether a client company's change of accounting methods is to a "preferable" method.

—To define, through formal rule-making procedures, the term "substantial authoritative support." The SEC traditionally has taken the position that accounting practices lacking substantial authoritative support are inherently "misleading" under the securities laws and thus subject to legal action.

If the SEC rejects the Andersen petition, it's expected that the accounting firm would sue for an injunction. In an interview from Chicago, George R. Catlett, an Andersen senior partner and its leading theoretician, declined to say what it intends to do, but "there obviously are other steps we can take," he said.

Three years ago, Andersen shocked the accounting profession by suing to enjoin a narrow SEC pronouncement on merger accounting. The SEC backed off, and the lawsuit was dropped. Andersen and the SEC also clashed when three Andersen auditors were indicted for securities fraud involving Four Seasons Nursing Centers of America Inc. When a federal jury acquitted two and failed to reach a verdict on the third, the Andersen firm accused the government of sweeping improprieties in bringing the indictments. Government officials have vehemently denied that accusation.

Though federal securities law empowers the SEC to adopt accounting rules for publicly held companies, the agency traditionally has relied on the accounting profession's recognized authorities to formulate rules and practices. The SEC has always exercised powerful influence over those bodies, however, and during Mr. Burton's tenure has moved aggressively to push the profession into new areas. In addition, the SEC has used its power to set new disclosure requirements to force the accounting profession to deal with such heated topics as lease accounting and inflation accounting.

The Andersen firm generally contends that it's illegal for the SEC to anoint the accounting profession's pronouncements as its own rules without first going through the formal requirements for notice and public hearings prescribed by the Administrative Procedure Act. In its petition, Andersen contends, for instance, that the SEC adopted ASR 150 "without even a pretense of compliance" with the act. In Andersen's view, ASR 150 was "the most significant and sweeping (accounting) rule" the SEC ever issued.

In ASR 150, the basic policy statement toward the standards board, the SEC not only accepted the past and future pronouncements of the board as having "substantial authoritative support." But it also declared that anything contrary to the board's rules would be deemed to lack such support. (The same status was accorded the unsuperceded pronouncements of the board's predecessors, the Accounting Principles Board and an earlier body.)

Andersen contends that the grant of exclusive authority hamstrings auditors by restricting them to a book of detailed rules, "some out of date and obsolete." It says auditors should be free to make a case for other practices. "There is a vast difference," Andersen said, "between (a) independent auditors voluntarily following professional pronouncements and (b) being required to follow such pronouncements by a rule of the commission."

The Andersen firm has a record of scrapping with the standards board (as well as with its predecessors). Harvey Kapnick, Andersen chairman, has scored the board for moving too slowly in dealing with pressing accounting problems. He has pointedly criticized Marshall S. Armstrong, its chairman, for allegedly failing to provide leadership.

Andersen's Mr. Catlett denied that the petition necessarily undercuts the standards board by forcing the SEC to start writing accounting rules itself. "We aren't advocating that they adopt them as (formal SEC) rules," he said, "but they ought to make up their mind and either not adopt them, or adopt them right."

Much of the accounting profession shares Andersen's opposition to the new SEC requirement that auditors comment on the "preferability" of client companies' changes in accounting methods. Last April, the SEC rejected a request by the Auditing Standards Executive Committee, the profession's top authority on auditing, that the agency drop the requirement.

In the auditors' view, the rule requires them to say that some equally permissible methods are better than others even though neither the SEC nor any other body has defined what "preferable" means. In numerous areas (such as merger accounting or accounting rules for oil-and-gas concerns) greatly differing methods coexist, partly because resolving the differences presents thorny theoretical problems. Mr. Catlett, the Andersen senior partner, said individual auditors shouldn't be expected to set accounting rules when the rule-making groups haven't been able to.

According to the SEC, the "preferability" requirement is contained in the accounting profession's own rules. The agency also sees the requirement as simply asking auditors to exercise professional judgment.

(From the Wall Street Journal, June 24, 1976)

Several Big Accounting Firms Criticize Andersen's Challenge of Standards Unit

By a WALL STREET JOURNAL Staff Reporter

NEW YORK—Several major accounting firms spoke out in support of the Financial Accounting Standards Board, the private-sector rule-making body whose authority was sharply challenged by Arthur Andersen & Co., another large accounting firm.

In an interview, Marshall S. Armstrong, standards board chairman, predicted that his institution couldn't survive if the Andersen challenge prevailed.

The rival accounting firms contended that Andersen's challenge, if successful, would probably lead to a government agency prescribing accounting rules for publicly held companies. "We vigorously oppose any actions which would hand this function over to the government," an Arthur Young & Co. spokesman said.

Last week, in a blistering critique, Arthur Andersen contested the right of the Securities and Exchange Commission to delegate blanket authority over accounting to the standards board. Andersen contended that the SEC couldn't hold companies or auditors to the board's pronouncements unless the agency first adopted them as its own rules, following the formal requirements of the Administrative Procedure Act.

Substantial Support for Rules

In Accounting Series Release No. 150, issued in December 1973, the SEC said the standards board's rules would be presumed to carry "substantial authoritative support" and anything contrary to them to lack such support. Accounting practices without such support have long been presumed "misleading" and actionable under federal securities laws.

In rebuttal, the other accounting firms took issue with Andersen's urging that ASR 150 be revoked.

"We believe ASR 150 should stand because we believe the standards should remain in the private sector," said Joseph P. Cummings, deputy senior partner of Peat Marwick, Mitchell & Co., the nation's largest accounting firm. He gave "unqualified support" to the standards board.

Mr. Cummings described ASR 150 as "a gesture on the part of the SEC to give the board authoritative support in its early years—which they desperately need." He noted, however, that he wasn't passing judgment on the legality of the SEC's procedures.

Seen Capable of Task

Philip L. Defliese, managing partner of Coopers & Lybrand and former chairman of the Accounting Principles Board (the standards board's immediate predecessor), reiterated that Andersen's position "would effectively place accounting rule-making in the hands of the SEC." In his view, the standards board "is capable of eventually performing" the rule-making task, and the SEC's traditional acceptance of the accounting profession's pronouncements "shouldn't be disturbed."

Russell E. Palmer, Touche Ross & Co. managing partner, said revoking ASR 150 "cannot be a serious suggestion." He said that the SEC adequately reserved its own prerogative to deal with specific accounting issues and wouldn't accomplish anything by formally and routinely adopting the standards board's pronouncement as SEC rules. "The FASB provides the only opportunity to pre serve accounting rule-making in the private sector where it belongs," Mr. Palmer said.

Peat Marwick, Touche Ross, and Arthur Young all agreed with a specific point raised by Andersen: its opposition to a new SEC requirement that auditors express an opinion on whether a client company's change of accounting methods is to a "preferable" method. But Charles G. Gillette of Arthur Young said, "It is deplorable that the Andersen petition is constructed in such a sweeping manner that it could, if successful, do irreparable harm."

Mr. Armstrong, the standards board chairman, also said he was "surprised and somewhat baffled" by Andersen's linking the "preferability" issue with revoking ASR 150. "I just don't see that it was necessary," he said.

Mr. Armstrong conceded past differences with the Andersen firm over the standards board's performance, but added, "I've generally thought they supported standards-setting in the private sector. If in fact they're attempting to espouse that view, they're going about it in a strange way."

Mr. Armstrong said that neither ASR 150 nor the accounting profession's ethics require an auditor always to follow the board's pronouncements. If in specific circumstances it would be misleading to do so, an auditor is obliged to depart from the rules, Mr. Armstrong said. This provision is rarely invoked, however.

Other than that narrow exception, Mr. Armstrong said the standards board depended on having exclusive authority. "To have our standards standing in competition with other standards—in the same set of circumstances—I don't think the board could survive," he said. "I don't think we could survive in that environment, no."

ARTHUR YOUNG & COMPANY

277 PARK AVENUE
NEW YORK, N. Y. 10017

May 10, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on Reports,
Accounting and Management
United States Senate
161 Russell Building
Washington, D. C. 20510

Dear Senator Metcalf:

Enclosed is the material described on the attached listing, submitted in response to your request of April 8, 1976. Also enclosed, is a description of information not available at this time, which should be obtained from the official source.

We assume that you will obtain presentations or testimony, which may have been given by the American Institute of Certified Public Accountants, in which personnel of our organization might have participated, directly from the Institute.

The submitted material does not include any presentations or testimony given in Executive or private session.

Yours very truly,
ARTHUR YOUNG & COMPANY

By______________________
Alan S. Berk

Enclosures

INFORMATION SUBMITTED TO UNITED STATES SENATE SUBCOMMITTEE ON REPORTS, ACCOUNTING, AND MANAGEMENT

1. Presentation by F. L. Tepperman on April 23, 1976 to Securities and Exchange Commission, together with Mr. Tepperman's letter (dated April 27, 1976) to The Honorable R. M. Hills, Chairman, Securities and Exchange Commission. The presentation and letter concerned the subject of "preferability" of accounting principles.

2. Firm letter (dated May 30, 1975) to Securities and Exchange Commission concerning proposals regarding quarterly financial statement data and review thereof by independent public accountants.

3. Firm letter (dated June 17, 1975) to Securities and Exchange Commission concerning notice of proposals to increase disclosure of interim results by registrants and notice of alternative proposals regarding such disclosure.

4. Firm letter (dated June 27, 1975) to Securities and Exchange Commission concerning notice of proposals with respect to disclosure of projections of future economic performance.

5. Firm letter (dated November 14, 1975) to Securities and Exchange Commission concerning notice of proposed amendments to Form 10-Q and Regulation S-X regarding interim financial reporting.

6. Firm letter (dated January 30, 1976) to Securities and Exchange Commission concerning proposed amendments to Regulation S-X to require disclosure of certain replacement cost data in notes to financial statements.

7. Firm letter (dated July 3, 1975) to Cost Accounting Standards Board concerning proposed cost accounting standard - "Composition and Measurement of Pension Cost."

8. Statement by E. L. Hicks, partner, Arthur Young & Company, before a hearing at the Securities and Exchange Commission on June 4, 1975, concerning quarterly financial statement data and review thereof by independent public accountants. (The transcript of the question and answer portion of the presentation should be obtained, by the Subcommittee, directly from the Commission.)

9. Firm letter (dated December 10, 1975) to Honorable Al Ullman, Chairman, Committee on Ways and Means, U.S. House of Representatives, Washington, D. C., concerning a transitional inequity in The Tax Reform Act of 1969, on behalf of a client (copy of printed public record).

10. Testimony by W. Findley, partner, Arthur Young & Company, at a hearing held on February 4, 1976 before the Subcommittee on Multinational Corporations of the Committee on Foreign Relations concerning a client.

11. Direct testimony of J. R. Plott, manager, Arthur Young & Company, at a hearing on May 16, 1975, before the North Carolina Utilities Commission, on behalf of a client.

12. Testimony and sworn statements by D. W. Auten, partner, Arthur Young & Company, to Federal Power Commission on behalf of clients on the following dates: two on January 13, 1975, May 30, 1975, September 5, 1975, November 3, 1975, and March 31, 1976.

13. Testimony by J. L. Harvey, Jr., partner, Arthur Young & Company, submitted on April 16, 1975 to the Federal Power Commission, on behalf of a client.

(Staff note: The enclosures referred to above are retained in the committee files.)

DESCRIPTION OF INFORMATION NOT AVAILABLE AT THIS TIME

1. Testimony of D. W. Auten, partner, Arthur Young & Company, before the Federal Power Commission in Docket No. E-8755 during the public hearing held January 13-16, 1975, on behalf of a client.

2. Sworn statement of D. W. Auten, partner, Arthur Young & Company, presented to the Federal Power Commission in Docket No. RM 75-14, on April 23, 1976, on behalf of a client.

3. Testimony by H. Hensold, partner, J. Parker, partner, and G. Laughinghouse, principal, all of Arthur Young & Company, to the Committee on the Executive of the Illinois House of Representatives on April 17, 1975. The testimony concerned the purchasing authority of the Illinois Department of General Services.

4. Testimony of R. E. Fischer, partner, Arthur Young & Company, on January 16, 1975 to the Nevada Gaming Board, on behalf of a client.

(Staff Note: The Arthur Young & Co. report to the AMA and related correspondence appear in the Congressional Record of 17 July, 1975, beginning on page S12957.)

[From the New York Times, June 29, 1975]

A.M.A. DEVELOPS REFERRAL SYSTEM TO PUT DOCTORS ON U.S. HEALTH ADVISORY PANELS

(By David Burnham)

WASHINGTON, June 28.—The American Medical Association has developed an elaborate referral system designed to channel onto 315 Federal health advisory panels doctors who agree with the philosophy of the association.

The advisory panels, which offer policy and technical guidance to the Department of Health, Education, and Welfare, sometimes play an important role in Government decisions affecting both the professional and economic interests of doctors and the health of the public.

The existence of the referral system became known after the distribution to several Washington newsmen of a series of internal documents written by A.M.A. staff officials and executives of Arthur Young & Co., a national consulting concern that worked on the system.

A spokesman for the A.M.A., in response to an inquiry, defended the referral system as helpful to the Government. But the documents indicate the association went to considerable lengths to keep its existence a secret even from its own members.

F. P. Rocco, a member of the consulting concern's Washington office, informed the Kansas City branch that the A.M.A. considered the development of the referral system "highly sensitive." He added, "Consequently we at their request and as a condition for receiving this assignment, have placed all files in a 'confidential' category and have limited access to it on a 'need-to-know' basis."

In another document a company official said, "It is strongly urged that all steps be taken to maintain a high security level on the nature and details of this system."

"It is unlikely," the official went on to explain, "that should such information become publicly known it would be properly understood by the Federal Government, A.M.A. members and the general population."

The consultant concern said that out of a total of 1,104 Federal advisory bodies in the Federal Government, the A.M.A. had decided to concentrate on 315 of the 355 such groups operating under the jurisdiction of H.E.W. The 315 committes, the report said, had a membership of approximately 3,500 individuals, with one-fourth terminating each year.

The consulting concern said the advisory panels "not only influence the development of Federal health policies and program regulations but they also influence the distribution of health grants, funds which affect the investment in various health, trends, programs, etc." It is, therefore, vital that the views of the A.M.A. be represented in the executive branch's deliberations on health care policy."

The purpose of the referral system, the report explained, was to make a "detailed search for a few 'ideal' physicians out of a total of 330,000 physicians in the country, or less than one one-hundredths of 1 per cent to be recommended for each advisory committee."

To make sure the physicians recommended by the A.M.A. for appointment followed the association philosophy, the consultant report said state medical societies would be used as a prime source for evaluating them. It continued:

"Each state medical society would participate in rating the practicing physicians in their state according to first or second hand knowledge of the medical qualifications, 'mainstream' of medical thinking, etc."

"By utilizing the state medical societies as evaluators, A.M.A. can build subjective data on physicians. Well-known A.M.A. members and the entire in-house A.M.A. staff are other sources for subjective data. These groups maintain frequent contact with numerous physicians throughout the nation and should be called upon to comment on the qualifications of the selected physicians, especially of those physicians selected for the powerful policymaking commissions."

The report defined "subjective data" as including measurements of the "individual's maturity, civic involvement, medical and political philosophy, activities which combine professional and nonprofessional * * *.

The original A.M.A. plan called for the vacancies on advisory panels and the selection of candidates to be accomplished on the association's computer. After paying Young & Co. at least $30,638.00 to develop the computer plan, the A.M.A. decided it would be too expensive and adopted a conventional filing system.

"But That Isn't Real Life"

If you ask an outside auditor whom he reports to, he's apt to waffle a bit.

"THEORETICALLY, it would be great to have the stockholders pick the outside auditors, and the auditors are at arm's length with management, and everything is very independent, and everybody gets a comfortable feeling," remarks William Gladstone, managing partner of Arthur Young & Co.'s New York office.

"But that isn't real life.

"Realistically," he goes on, "management selects the auditors." The fact that outside auditors are appointed by boards of directors with stockholder approval has become a legal fiction, says Gladstone.

"Real life" is also that outside auditors *report* to management—not to boards of directors as they are supposed to. While most boards now have an audit committee (generally added—at the urging of outside auditors—in the past six or seven years), it usually meets with these outside auditors for only four or five hours twice yearly. Says Gladstone: "Ninety-nine percent of all problems that come up are settled with management. It's very, very unusual to go to the board with a problem."

Belatedly, some boards now wish the outside auditors *had* come to them with those problems. One of those boards is an Arthur Young client named Lockheed Aircraft.

For obvious reasons, Gladstone doesn't want to talk about Lockheed. But he defends the way his competitors at Price, Waterhouse & Co. audited Gulf Oil, which has confessed to equally massive overseas payoffs.

"I don't think a typical audit is designed to uncover even things of that magnitude in a company of that size," he says. "Auditors don't audit everything. False entries made by people in responsible positions—auditors can't pick that up."

Nevertheless, the recent publicity about corporate overseas payoffs has reminded boards of directors that the auditors are in fact their investigative arm. This worries Bill Gladstone.

"You can't be an adversary and do an audit of a company," he asserts. "Primarily, a board's information about a company should come from management. If the board members don't think they've got management who will give them the information, then they ought to get other management. You shouldn't find out what's going on in a company from the auditors unless the company's withholding something. And then, of course, you have this contact with the auditors at least twice a year—you can call them anytime you want."

What's The Point?

Then why bother hiring an independent outside auditor in the first place? If you're never going to be in an adversary relationship with management, then your independence is worthless, isn't it?

"When you get close to management," says Gladstone, "it doesn't hurt your independence, it *enhances* it."

How's that again?

"It's not wrong to be imaginative, say, in helping management account for an acquisition," he goes on. "That's proper. If you're constantly finding out how you can do things for them, and they know you're not a 'no' fellow but somebody who's positive, then when you say, 'Well, you just can't account for something that way—that's wrong,' they say 'O.K., we won't.' But if your position is one of an adversary all along the way and you're always saying, 'no, no, no'—and you say 'no' again on an important point, they'll say, 'The hell with him! We're just going to do it and if he doesn't like it he can qualify his report.' So the better relationships are where you're a plus to the company—helpful to them."

For such obliging auditors with a "positive" attitude, management can be equally helpful. It can, say, channel lucrative corporate business to the auditor's tax and management consulting associates. Gladstone concedes that "a very large percentage" of Arthur Young's tax and consulting business is with its audit partners.

Isn't that a conflict of interest? "We don't view it that way," says Gladstone. "Because anything we can do to improve controls makes it a better audit."

Of course, it is not the independent auditors who are to blame for loving the hand that feeds them. The fault lies with the board of directors for abdicating its oversight function to such an extent that its hired investigators, the auditors, look upon their allegiance to the board as a polite fiction. Under such circumstances it is a frail defense to cry, as did the outside directors of Gulf Oil: "We weren't kept fully informed." They *could* have asked the auditors. ■

From the New York Times, Dec. 5, 1975

Industry's Conflict on Bribery Abroad Is Laid to Guidelines 'After the Fact'

By RICHARD PHALON

David James, a managing partner of Arthur Young & Company, a major accounting firm, said yesterday that a lack of guidelines was a major reason why American businessmen had run into conflict over the question of bribing foreign government officials.

Mr. James commented during a seminar on business morality at the annual Association of Manufacturers at the Waldorf-Astoria Hotel.

Mr. James said industry was getting guidance only "after the fact" from the Securities and Exchange Commission and from Senate committees.

S.E.C.'s Questions

"After the fact," Mr. James said, "business is being told, 'Oh, my, look what you've done; it's terrible.' But there is no guidance. If guidance can destroy you after the fact, then you are in real trouble."

The Securities and Exchange Commission in recent months has raised extensive questions about the dealings of numerous American companies abroad and sizable payments made to foreign officials, ostensibly to increase sales or otherwise advance corporate interests.

The S.E.C.'s questions have focused mainly on disclosure to stockholders and the accountability of payments that were in many instances made in cash or through false billing and bank accounts.

Ray E. Garrett Jr., former chairman of the S.E.C. and now a member of a Chicago law firm, told the panel that business had to make up its own mind about the morality of such payments and suggested that rule-making in the area was difficult.

"There is unquestionably a difference," Mr. Garrett said, "Between dealing with big-ticket items in small countries," where payments were more or less taken for granted, and handling similar items in developed countries.

Suggestion Made

Placing before stockholders the issue of whether a corporation should pay a substantial bribe to foreign officials to protect its assets, Mr. Garrett said, is probably the best way to meet S.E.C. disclosure requirements.

He also underscored, however, moral and practical considerations that troubled other members of the panel.

If management or stockholders agree to such payments, "then we're patsies for every two-bit dictator who wants to extort his 60 bucks," he said.

Still another panel on the need for regulatory reform heard Michael H. Moskow, chairman of the Council on Wage and Price Stability. He said that Federal health and safety standards often imposed unnecessary standards on businessmen.

His council, Mr. Moskow said, is using as much leverige as it could muster with other Federal agencies to make regulation more realistic in terms of business needs and costs.

Example Described

He cited, as one such instance of intervention, questionsthat the council had raised with the Food and Drug Administration over newly proposed reWgulations on shell fishing.

The regulations, still under consideration, Mr. Moskow said, would raise the price of oysters in the Washington, D.C. area as muoh as 40 percent.

Thomas A. Murphy, chairman of the General Motors Corporation, told the meeting that Americans of "moderate mind" should make more of an effort to assert themselves.

"In general," he said, "we must all become more active than we are in legislative and political affairs. We must learn to write letters—not just occasionally, but regularly—to our elected representatives at every level of government."

The N.A.M. meeting is scheduled to resume today at 9 A.M.

Peterson's Topic

At another panel, late in the afternoon, former Secretary of Commerce Peter G. Peterson reiterated the frequent contention that the United States is suffering from a serious shortage of capital. He suggested that leading businessmen become personally involved in persuading Congress that new tax laws are needed.

"We must apply the techniques learned in marketing our products to marketing our philosophy," Mr. Peterson said. He is now chairman of Lehman Brothers, a major investment banking firm.

The idea that the country is short of capital is widely popular among dusinessmen. An N.A.M. committee recently approved a resolution calling for six major tax incentives to stimulate capital investment. And no one on the panel—which also included George G. Hagedorn, vice president and chief economist of the N.A.M., and Frederick L. Bissinger, vice chairman of the Allied Chemical Corporation—or in the audience intimated that there might not be a shortage.

It was, Mr. Peterson said later, like "preaching to the choir."

Mr. Bissinger said that more capital investment leads to more jobs. He added, "We talk a lot about capital formation but not enough about job formation."

(From the Wall Street Journal
October 25, 1976)

Pullman Used Auditor to Make Payment Abroad

Arthur Young Apparently Served as Conduit for A 'Presumed' Tax Bribe

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON – Pullman Inc. said its questionable overseas payments included money funneled through its independent auditors, "presumably" for the purpose of bribing the tax officials of a foreign country.

Pullman didn't say so directly, but the auditor that served as the payment conduit apparently was Arthur Young & Co., which also helped conduct the investigation that turned up the questionable payments.

In a report to the Securities and Exchange Commission, Pullman also disclosed that its questionable payments in the five years beginning Jan. 1, 1971, were found to total more than $3.4 million, up from the $2.2 million it reported earlier.

The presumed tax bribe, amounting to about $5,000, in itself isn't significantly different from many such "facilitating" payments that U.S. companies have reported making to foreign government officials to hold down tax bills, clear goods through customs and for other purposes. However, the use of an independent auditor as a conduit may be the first such instance in the agency's voluntary disclosure program.

Pullman, headquartered in Chicago, said the $5,000 was part of $62,000 paid to "minor government officials" during the five years covered by its audit. The payments generally were "to expedite the performance of expected day-to-day activities" of the recipients, the transportation equipment and engineering company stated.

The report said the $5,000 was paid in 1972 and 1973 by a Pullman subsidiary in the form of a check "to a foreign office of the company's independent auditor." The auditor, identified elsewhere in the report as Arthur Young, in turn paid the money "to a taxpayers' association" in the same country and "presumably" it then was "passed on to an official . . . who could influence the outcome of the subsidiary's tax situation." The payments were "in accordance with a not-uncommon practice in such a country, to achieve finalization of tax returns . . . without sizable additional assessments," the report said.

Other additional payments reported by Pullman included $674,000 paid "to a numbered bank account at the request of a then-official of a business corporation owned by a foreign government." These payments, described as "commission," were "in connection with securing work," the report stated.

Pullman also disclosed further additional payments totaling $557,000 "to intermediaries of foreign government officials as fees and commissions," also for the purpose of securing work.

Pullman said its investigation has caused it to increase its net tax liability $200,000 for the first half of the current year and another $750,000 for the third quarter. In the same report, the company also disclosed that devaluation of the Mexican peso will reduce third quarter profit $3.2 million after taxes. Historically, the Mexican operations contribute less than 2% of the company's consolidated earnings, but the charge against income in the third quarter is required by U.S. accounting standards, the company noted.

In New York, William S. Kanaga, managing partner of Arthur Young & Co., said: "It was Arthur Young's own review, requested by Pullman Inc., which disclosed the transmittal on Pullman's behalf of the $5,000 referred to in Pullman's 8K. The transmittal was made by one foreign national in an overseas office to a taxpayers' association. This is the only such transmittal of which we are aware.

"We will continue our investigation and if additional action is necessary, we will take it," he said.

COOPERS & LYBRAND
1251 AVENUE OF THE AMERICAS
NEW YORK, N.Y 10020

PHILIP L. DEFLIESE
MANAGING PARTNER

May 4, 1976

Hon. Lee Metcalf, Chairman
Subcommittee on Reports,
Accounting and Management
United States Senate
161 Russell Building
Washington, D. C. 20510

Dear Senator Metcalf:

Reference is made to your letter of April 8, 1976. Because we had questions about the interpretation of your requests we sought guidance from a member of your staff.

As a result of this discussion we understand that your letter should not be interpreted as seeking testimony or presentations made by this Firm on behalf of specific clients or on behalf of itself in a private proceeding. We also understand that under the time limitations posed by you an exhaustive search was not necessary, but that a cross-section of the types of public positions on general issues taken by our Firm would be acceptable.

Therefore, enclosed are the following which we understand will fully satisfy the requests contained in your letter of April 8, 1976:

1. Letter dated March 14, 1975 to the Securities and Exchange Commission with respect to Release No. 33-5548.

2. A Comparative Study of Tax Systems and Their Effect on Foreign Mining Investments as of May 12, 1975 as submitted to the House Ways and Means Committee.

3. Letter dated June 2, 1975 to the Securities and Exchange Commission with respect to File No. S7-542.

4. Letter dated July 31, 1975 to the Securities and Exchange Commission with respect to File No. S7-561.

5. Letter dated September 4, 1975 to the Federal Power Commission with respect to Docket No. RM 75-27.

6. Letter dated November 26, 1975 to the Federal Power Commission with respect to Order No. 530.

7. Brochure dated February 1976 with respect to Replacement Cost Accounting.

8. Letter dated March 23, 1976 to the President of the American Mining Congress which was submitted to the House Ways and Means Committee.

In addition the following appearances were made by persons associated with this Firm for which transcripts are not readily available:

	Date	Commission	Subject
9.	Feb. 18-21, 1975	Ontario Energy Board, Ontario Canada	Accounting & Reporting Requirements if the Board would take jurisdiction of Ontario Hydro
10.	Mar. 12-14, 1975	District of Columbia - Public Service Comm.	To teach new Chair-person and staff a two-day course in Public Utility Ratemaking and Rate Design
11.	May 13-15, 1975	New York Public Service Comm.	To teach staff at New York Public Service Comm. two-day course in Public Utility Ratemaking and Rate Design
12.	June 18, 1975	Federal Power Comm.	Design of rates for a suburban borough of Tampa
13.	June 20-22, 1975	City of Anchorage	Water rates conference
14.	Sept. 11, 1975	Federal Power Comm. (Rate Staff)	Accounting for Special LNG Plant

	Date	Commission	Subject
15.	Dec. 11, 1975	Federal Power Comm. Accounting Staff	Accounting for cash settlement from the contractor of a cancelled nuclear power plant
16.	Feb. 23-24, 1976	Federal Power Comm. (Testify)	Explain how depreciation rate of 5% for nuclear plants was developed
17.	Feb. 27, 1976	Public Service Comm. of the State of Delaware	Related to the accounting method used to reflect the cash settlement from the contractor of a cancelled nuclear power plant, within the application for a general increase in electric rates.
18.	Mar. 1-3, 1976	City of Wyandotte Michigan (Comm.)	Teach rate course and help to develop rates
19.	Apr. 7, 1976	Wayne County (Detroit)	Presentation on utility rates

Very truly yours,

Philip L. Defliese

Philip L. Defliese

PLD:dem
Enc.

COOPERS & LYBRAND

IN PRINCIPAL AREAS
OF THE WORLD

1251 AVENUE OF THE AMERICAS
NEW YORK, N Y 10020

September 4, 1975

Mr. Kenneth F. Plumb, Secretary
Federal Power Commission
Washington, D. C. 20426

Re: Notice of Proposed Rule
Making, Docket No. RM75-27
May 20, 1975

Dear Mr. Plumb:

The Notice of Proposed Rulemaking in Docket No. RM75-27 proposes amendments to the Uniform Systems of Accounts for Public Utilities and Licensees and for Natural Gas Companies to provide for the determination of the rate for computing the allowance for funds used during construction and revisions of certain schedule pages of FPC Reports.

We are a firm of independent certified public accountants among whose clients are utility companies subject to the jurisdiction of the Federal Power Commission. We present our comments on this proposed rulemaking in the knowledge that the Commission in Docket RM75-13 proposes that construction work in progress be included in rate base thereby considering such expenditures in setting current rate levels and thereby providing current cash income. In the absence of such treatment, we believe implementation of the proposed rule on which we are now commenting, while not providing current cash revenues, will better enable a utility to construct new facilities without causing a significant adverse effect on its earnings on plant in service. We also believe that it will be useful in clarifying some

of the misunderstandings on the part of the public, investors and security analysts with respect to the nature of AFUDC.

Our comments and suggestions are as follows:

(A) <u>Formula computation of the AFUDC rate - Use of short-term interest rates and embedded rates for long-term debt and preferred stock</u>

The formula computation gives full recognition to short-term interest rates. We consider this desirable since funds from short-term borrowings are principally used to finance construction programs and only to a much lesser extent for other purposes. The proposal requires the use of actual book cost rates (embedded) for long-term debt and preferred stock. The use of embedded cost rates, which include those reflecting earlier issues at historically low interest and dividend rates, runs contrary to the actual use of funds since only currently obtained or generated funds are in fact expended for current construction purposes.

We believe that the use of more current rates for long-term debt and preferred stock will more clearly reflect "the net cost for the period of construction of borrowed funds used for construction purposes..." In our opinion, the use of the preceding year rate or at the outside, a three year average rate (which may approximate a utility's average construction period) would be more appropriate.

We believe the proposed annual determination of the rates for both the debt and preferred stock components in the formula for the purpose of computing the AFUDC rate may prove to work inequities with respect to both utilities and the rate-payers depending upon the direction of the change in the

general level of the cost of funds during the year. Since money costs have in recent years fluctuated frequently, we suggest that quarterly or semi-annual determinations be made and that the criterion for changing the AFUDC rate be a variation of say $\pm$ ¼%.

(B) Formula rate attributable to common equity is the rate allowed by the regulatory commission having primary jurisdiction

It is proposed that the determination of the rate for common equity be the rate granted in the last rate proceeding before the ratemaking body having primary rate jurisdiction or if such rate is not available, the average rate actually earned during the preceding three years. While most or perhaps all utilities have had rate determinations in recent years, the proposed wording would require the use of a rate determination (however old) which might prove to be inequitable. We suggest that consideration be given to setting a vintage limit on the last rate determination for use in the formula and permit an alternate determination to be applied under those circumstances.

In general, the common equity rate allowed would presumably be higher for a utility in a state in which rate of return is based on original cost, than in a state in which rate of return is based on fair value. We suggest that recognition be given to a situation in which this condition prevails in order to permit an equitable adjustment of the rate attributable to common equity.

(C) Commission proposal is silent with respect to use of the compound interest method

Some state commissions require utilities under their rate jurisdiction to compute AFUDC by applying the accrual rate to a base which includes previously accrued AFUDC (compound interest method) rather than the simple interest method. We believe that such determination is appropriate under the circumstances and further believe that the Commission should use the occasion of the issuance of this new rule to specifically set forth its requirements or position on this matter.

(D) Reclassification of AFUDC on Statement of Changes in Financial Position

We concur in the proposed deduction of the other funds portion of AFUDC in determining total sources of funds from operations. With respect to the application of funds section, a basic consideration is that total construction and plant expenditures (including total AFUDC) is a most meaningful and significant amount in reporting the changes in financial position of every utility. We believe therefore that nothing should be done to in any way change or imply a change in the amount of construction and plant expenditures which are recorded in the accounts and are presented in this statement. To accomplish this, the allowance for other funds could be presented as an application of funds (negative) without any reduction of total construction and plant expenditures.

(E) Reclassification of the borrowed funds portion of AFUDC from Other Income to Interest Charges (Credit)

We recommend that the Commission give consideration to the possible impact on the computation of the earnings coverage ratios (under a utility's charter and bond indentures) which may result from the proposed inclusion of only the other funds portion of AFUDC in Other Income.

(F) Effective Date

The effective date for any amendments to the Uniform Systems of Accounts (as contained in the proposed rulemaking) should be specifically stated and be prospective in order to avoid the necessity for any restatement or other retroactive adjustment of previously issued financial statements.

In accordance with the Notice of Proposed Rulemaking, we enclose an original and fourteen copies of this letter. Please address any communications concerning the proposal to:

Mr. Robert W. Egner, Partner
Coopers & Lybrand
1251 Avenue of the Americas
New York, New York 10020
Telephone: (212)489-1100

Although we have not requested a conference with the staff of the Commission to discuss our comments in detail, we would, of course, welcome an opportunity to attend any conference on this proposal which may be called by the Commission.

Very truly yours,

Coopers & Lybrand

RWE:eo

COOPERS & LYBRAND

IN PRINCIPAL AREAS
OF THE WORLD

1251 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10020

November 26, 1975

Mr. Kenneth F. Plumb, Secretary
Federal Power Commission
Washington, D. C. 20426

Re: Order No. 530 Dated June 18, 1975
Order Implementing that Portion of Docket No. R-424 Relating to Interperiod Allocation of Income Taxes and Docket No. R-446 to Achieve Comprehensive Interperiod Allocation of Income Taxes

Application by Public Systems for Rehearing of Order No. 530 and, if Required, for Leave to Intervene

Order Dated August 15, 1975
Granting Applications for Rehearing for the Purpose of Further Consideration

Dear Mr. Plumb:

Under date of August 15, 1975, the Federal Power Commission issued an order granting a rehearing for the purpose of further consideration of its Order No. 530. This letter is submitted to the Commission for the purpose of presenting our comments on Order No. 530 and the application filed by Public Systems. We are a firm of independent certified public accountants among whose clients are public utility companies subject to the jurisdiction of the Federal Power Commission. Our reaction to the order granting the rehearing was one of considerable surprise and

concern as we had considered Order No. 530 to be beneficial to both the utility rate payer and stockholder and to represent clear evidence of the Commission's desire to prescribe tax accounting (when consistent with the rate-making treatment) which conforms with the required tax accounting for non-regulated industries.

It would be expected that the application submitted by Public Systems for rehearing of Order No. 530 would bring to light arguments not previously considered or new evidence of a significant nature which would make reconsideration appropriate. We have read such application for rehearing of Order No. 530 and we have found neither. Nevertheless, the application provides an opportunity to acknowledge the soundness of the considerations underlying Order No. 530.

Comments on Order No. 530

On page 10 of the Order, the Commission succinctly states the principal problems of the electric industry today -- "... it is presently faced with a cash shortage, cutbacks in construction programs, and severe difficulties in raising required capital to provide funds for the necessary growth." The Commission further stated unequivocably as follows:

> "The adoption of normalization of income taxes for rate purposes will contribute to the health of the electric and natural gas industries by increasing cash flow and by reducing external financing requirements. In addition, normalization will contribute to the financial stability of companies and improve fixed charge coverages."

We fully agree with the foregoing observations of major industry problems and the benefits which could be expected from full adoption of normalization of income taxes for rate purposes. The appropriate accounting (comprehensive interperiod allocation of income taxes) should, of course, follow such rate-making treatment. The Order appropriately states on page 13 that "Comprehensive interperiod income tax allocation should not be prescribed for accounting purposes prior to the respective tax timing differences being allowed in rates as resulting financial statements would be distorted."

As noted on page 5 of the Order, "Comprehensive interperiod income tax allocation -- is well supported by accounting theory" and footnote reference is made to Opinion No. 11 of the Accounting Principles Board (APB) of the American Institute of Certified Public Accountants. Accounting for income taxes is presently governed primarily by APB Opinion No. 11 and Addendum to APB Opinion No. 2. When book/tax timing differences exist, APB Opinion No. 11 requires comprehensive interperiod income tax allocation in financial statements with the exception that the Opinion does not apply to regulated industries in those circumstances where the standards described in the Addendum to APB Opinion No. 2 are met. The just published Montgomery's Auditing (Ninth Edition) contains the following discussion (pages 525-526) on accounting for income taxes by public utilities.

Public Utilities

"Addendum to APB Opinion No. 2 permits public utilities to apply generally accepted accounting principles differently from non-regulated companies because of the rate-making process, which attempts to provide a specified rate of return to the affected utilities. Such differences usually relate to the time at which the regulatory commissions permit various items to enter into the determination of net income in accordance with the principle of matching costs and revenue. Accordingly,

deferred income taxes and investment credits are recorded by public utilities only to the extent such deferred amounts are allowed as currently recoverable costs for rate-making. Examples of timing differences for which deferred income taxes need not be provided if they are not an allowable cost include: (1) overhead costs associated with construction which are capitalized for accounting purposes and expensed for tax purposes; (2) interest portion of the allowance for funds used during construction (interest charged construction) capitalized for accounting purposes; and (3) excess of tax depreciation attributable to the use of accelerated methods and shorter lives for tax purposes. However, in certain circumstances, since 1970 the Internal Revenue Code and Regulations have permitted accelerated depreciation, ADR lives, and investment credits on post-1969 plant additions only if a public utility elects (and a regulatory commission allows) deferred treatment of such timing differences and investment credits for accounting and rate-making purposes. As a result, some utilities follow a combination of deferred and flow-through accounting methods.

The Federal Power Commission revised its Uniform System of Accounts (effective in 1975) pertaining to the deferral of income taxes to substantially conform its prescribed accounting for interperiod income tax allocation with tax accounting for non-regulated industry (unless the regulatory commission having primary rate jurisdiction requires less than full deferral)."

The accounting profession has permitted flow-through (cash basis accounting for income taxes) when prescribed for rate-making purposes as an acceptable alternative to normalization for public utilities when there is reasonable assurance that future rate determinations will allow the increased income taxes resulting from the flow-through of the earlier deduction. Thus, accounting has adapted itself to the variations in rate-making practices among the various rate-making jurisdictions in order to reflect the <u>matching of revenues with costs allowed for rate purposes</u>.

It should be recognized, however, that the American Institute of Certified Public Accountants is on record as believing that regulatory authorities should permit the recognition of deferred

income taxes for both accounting and rate-making purposes. The accounting profession believes that the basic principles of accounting used by regulated companies should not differ from those used by non-regulated companies and therefore, full normalization is appropriate.

Underlying normalization accounting is the concept that an advance tax benefit is obtained when depreciation or other costs can be deducted for tax purposes earlier than they are deemed to accrue for accounting purposes and is offset in later years when the situation reverses. Since 1958, it has been a generally accepted accounting principle that an advance tax benefit should be deferred in the accounts until such time as the situation reverses so that the tax provision in the income statement is proportionate to the items giving rise to such income tax -- that is, they are matched, and thus net income is fairly presented. Although no present requirements to pay such taxes may exist, the deferred tax account serves as an allocation account to provide a proper flow of tax costs in the determination of periodic income and to avoid the use of cash basis accounting for income taxes. Many regulatory commissions have seen the merit to this argument and have prescribed normalization. Certainly it is clear from the enactment of various tax laws by Congress since 1969, that the failure of a regulatory commission to permit normalization of the tax effect of certain transactions in rate-making would be contrary to our national tax policy and would deny the subject company the right to avail itself of the particular tax benefit.

The importance of the normalization concept in the view of the President's Labor Management Committee is most apparent in its recent recommendations. In May 1975 this Committee expressed its concern over the ability of the electric utility industry to

meet the energy demands of the 1980's. It recommended a number of administrative and legislative changes to stimulate this sector of the economy. Among the changes were amendments to the Internal Revenue Code which would:

1. provide a permanent 12% investment credit on all electric utility property, except petroleum fueled generating facilities;
2. provide immediate investment credit on progress payments for certain construction in progress, except petroleum fueled generating facilities;
3. permit 5-year amortization of the costs of converting or replacing a petroleum fueled generating facility;
4. allow depreciation during construction on certain construction work in progress.

It should be noted that <u>in each instance, the recommended legislation would be contingent upon normalized tax treatment</u>. In presenting proposals of the President's Labor and Management Committee to the House Ways and Means Committee, the Secretary of the Treasury noted:

> "We have said many times that the most fundamental problem with respect to electric utilities is the problem of adequate rates. Unless the users of electrical energy are required to pay the full costs of generating it, including a reasonable return on invested capital, investors cannot be expected to invest in the industry. It is apparent that this has already occurred to a substantial degree. Electric utility equities have in many cases been selling at substantially below book value, and many companies have been unable to borrow except at interest rates that are prohibitive."

He added:

> "The proposals are designed to provide help through the tax system, but only if the regulatory authorities and consumers

> cooperate in doing their part. Several of the tax proposals are designed to provide incentives that will make it easier for state regulatory commissions to take the difficult steps which must inevitably be taken. The increase in the investment credit will be a cash contribution by the federal government (emphasis supplied) for the construction of additional electric power plants. But, because of the limitation that the credit may be used only to offset tax liability, the regulatory commissions will have to do their part by setting rates that are sufficient to create a reasonable profit and a tax liability against which the credit can be offset ---."

Comments on Application for Rehearing

The application for rehearing submitted by Public Systems makes the following points to which we wish to respond:

1. normalization of income taxes imposes non-existent costs upon the consumer, and
2. normalization of income taxes represents an inefficient means of subsidizing the industry.

The argument advanced in the application of Public Systems is that deferred income taxes do not represent a cost incurred by a public utility. In our judgment, deferred income taxes applicable to a transaction occurring in the current period are clearly an element of cost of service in the current period and should therefore be reflected in billings to the current consumer.

The timing differences which give rise to tax deferrals are in part set forth in Order No. 530. The income measurement problem associated with these timing differences is clearly stated in APB Opinion 11.

> "Interperiod tax allocation procedures have been developed to account for the tax effects of transactions which involve timing differences. Interperiod allocation of income taxes results in the recognition of tax effects in the same periods in which the related transactions are recognized in the determination of pretax accounting income."

Under comprehensive tax allocation, tax effects are associated in the books of account in the same accounting period as the related transactions, even though some transactions may affect the amount of taxes payable in a different period. It is indisputable that the amount of income taxes payable for a given period does not necessarily measure the appropriate income tax expense related to transactions for that period. Clearly, the tax effects of initial book/tax timing differences should be recognized and should be matched with or allocated to those later periods in which the initial differences reverse. The fact that when the initial differences reverse, other initial differences may offset any effect on the amount of taxable income, does not nullify the need for,or the effect of,the reversal. The tax effect on the differences can be readily measured. The makeup of the balance of certain deferred tax amounts "revolve" as the related differences reverse and are replaced by similar differences. The fact that the tax effects of two transactions go in opposite directions does not invalidate the necessity of recognizing separately the tax effect of the transactions as they occur.

In arguing that normalization imposes non-existent costs upon the consumer, Public Systems mistakenly believe that some or all timing differences are in fact "permanent differences", and in fact constitute tax savings. Permanent differences may arise under income tax laws because certain income items are exempt from taxation and certain expense items are not deductible. Examples of tax-exempt revenues are life insurance proceeds and interest on municipal obligations. Examples of non-deductible expenses are premiums paid on officers' life insurance and fines. Permanent differences may also occur if an item is never recognized in determining accounting income. Examples of these are the excess of statutory depletion over cost depletion and the deduction for certain dividends which

are recognized for tax purposes but not for accounting purposes. Obviously, tax effect is not given in the accounts for these types of transactions. However, in the case of any specific timing difference, there is no question that book and tax will at some point be brought into agreement. The argument that it is not necessary to recognize the tax effect of timing differences on a current basis so long as similar timing differences can be expected to arise in the future creating tax effects at least equal to the reversing effects of the previous timing differences is unquestionably at variance with the economics of any transaction. There is nothing phantom about such an expense since it is only a question of when the income taxes will be paid and not whether.

It is argued by Public Systems that in the aggregate tax deferrals will continue to accumulate notwithstanding the reversal of individual timing differences. We agree that in a period of plant expansion and inflation such will be (and, in fact, has been thus far) the result. However, the allowance by regulatory commissions of more realistic amounts of depreciation for both rate and accounting purposes would substantially reduce the current provision for such tax deferrals as well as the accumulated amount thereof.

In any discussion of normalization versus flow-through there are certain significant factors that should be kept in mind concerning recovery of costs invested in plant. The cost of plant assets is recovered in two ways. The first element -- depreciation -- is charged to the rate payer as part of the cost of rendering service. The second element -- tax deduction for the depreciation allowance -- is passed to the rate payer as a reduction in the cost

of rendering service. In essence, the utility recovers part of its invested cost from rate payers and the balance from the government. But, what happens under flow-through? The major part of the tax cost-recovery element is obtained in the early years and is passed to the consumer in the form of reduced rates. In the later years when the utility plant becomes older and its relative efficiency decreases, the tax cost recovery also decreases, all resulting in higher rates to the consumer. In an age of rapid technological advancement, this result defies logic.

In contending that normalization represents an inefficient means of subsidizing the public utility industry, Public Systems points to the fact that income taxes currently payable will be increased as a result of the inclusion of deferred income taxes in cost of service. Inevitably the inclusion of deferred income taxes in the cost of service with resulting increased revenue requirements increases taxable income in the current year. This is a fact which is recognized by all. At the same time, the reversal in subsequent periods of previously deferred income taxes reduces the income taxes which would otherwise be includible in cost of service, and by application of the same theory decreases future revenue requirements. In other words, over a period of years with or without comprehensive interperiod allocation of income taxes, the same amount of federal income taxes (assuming constant rates) will have been paid and reflected in cost of service. The contention by Public Systems is not valid.

Public Systems further contends that deferred income taxes represent an involuntary contribution or interest-free loan by the consumer. On the contrary, it is the federal government and not the consumer which is providing the "contribution" by allowing the tax benefit. The trend of requiring normalization as a condition

67-159 O - 77 - 45

of certain tax benefits which began with the Tax Reform Act of 1969 represents an expression of the Congressional intent that a utility should retain the deferred income taxes rather than flowing them through to the consumer. The trend toward normalization evidenced in many recent rate orders bears further witness that state regulatory commissions are accepting the validity of this concept. Order No. 530 fits appropriately into this framework.

Summary

We believe that normalization is an economically sound concept for public utilities. It provides the utility company, through the rate-making process, with the ability to retain the immediate cash flow resulting from the deferral of income taxes and at the same time ensures that future as well as current rate payers obtain their fair and equitable share of the tax benefits related to timing differences. It follows that where normalization is used, internally generated funds are obviously greater than when tax benefits are "flowed through". This additional cash flow becomes available for construction and working capital requirements, decreases the need for external financing and strengthens the utility's financial position. We believe it essential that normalization procedures be used in order to better ensure the financial integrity of utilities. We also believe that Order No. 530 will result in greater conformity of tax accounting for public utilities, as established by regulatory commissions, with tax accounting for non-regulated industries.

We fully support Order No. 530 and commend the Commission's action in providing for comprehensive allocation of income taxes when consistent with the rate-making treatment.

We have enclosed an original and fourteen copies of this letter. Please address any communications to:

Mr. Robert W. Egner, Partner
Coopers & Lybrand
1251 Avenue of The Americas
New York, New York 10020

Telephone: (212)489-1100

We would welcome an opportunity to attend any conference on this rehearing which may be called by the Commission.

Very truly yours,

Coopers & Lybrand

RWE

(Staff note: The other enclosures from Coopers & Lybrand are retained in the committee files.)

ERNST & ERNST
UNION COMMERCE BUILDING
CLEVELAND, OHIO 44115

May 19, 1976

The Honorable Lee Metcalf, Chairman
Subcommittee on Reports, Accounting
and Management
Committee on Government Operations
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

In response to your letter dated April 8, 1976, we submit the attached information which was developed through a survey of our offices.

If we can be of any further assistance to your Subcommittee, please let us know.

Very truly yours,

R. T. Baker

R. T. Baker
Managing Partner

RTB/nm
attachments

	Body (Congress, State Legislature, Government Agency	Date	Title or Description of Testimony or Presentation
.	Commonwealth of Massachusetts - Department of Public Utilities		DPU 18205-A, reconciliation of billing and collection under fuel adjustment clause from 1/1/73 to 7/31/74. If complete hearing testimony is required, it can be obtained from the Massachusetts Department of Public Utilities (approximately 550 pages). Attached are excerpts of testimony by W. A. Morrison of Ernst & Ernst.
.	Ohio Senate Senate Committee Elections Financial Institutions and Insurance	2/17/76	Testimony on House Bill 448 relative to the approval of hospital association contracts and the power of the Superintendent of Insurance.
.	House Committee on Finance, State of Hawaii Legislature	2/12/75	Testimony on House Bills 436-75; 438-75; and 442-75.
.	Senate Ways & Means Committee, State of Hawaii Legislature	2/23/76	Testimony on Senate Bill 2322.
.	House Committee on Finance, State of Hawaii Legislature	3/05/76	Testimony on House Bill 2846.
.	State of Indiana acting through the Public Service Commission of Indiana	7/75 10/75	Cause No. 33735 S-1. Testimony submitted to fulfill the agreement between Ernst & Ernst and the State of Indiana acting through the Public Service Commission of Indiana to perform a review of the fuel cost adjustment clauses.
.	Missouri Senate - State Department Committee		Testified in support of House Bill Numbers 1034 and 1110, as amended, and as they related to Licensing of Employment Agencies in the State of Missouri.

Body (Congress, State Legislature, Government Agency	Date	Title or Description of Testimony or Presentation
Internal Revenue Service	2/18/75	Writedowns of obsolete inventory under LIFO.
Internal Revenue Service	2/20/75	Proposed procedural rules with respect to public inspection of certain rulings and determination letters.
Internal Revenue Service	3/03/76	Extension of 3/15/76 deadline described in Rev. Proc. 76-6 for "perfecting" prior years' LIFO elections.
Internal Revenue Service	4/26/76	Proposed amendement of Section 1.103-1, Income Tax Regulations
Internal Revenue Service	6/10/75	Full Absorption Method of Inventory Costing
Internal Revenue Service	10/30/75	Comments on Proposed Form 5500 (Re: Employee Benefit Plan Reporting)
Internal Revenue Service	11/19/75	Additional comments on Proposed Form 5500
U.S. Treasury Department	3/11/76	Section 1.1502-26(a), Income Tax Regulations
Special Advisory Commission on Electrical Utility Rates and Regulations, State of Kentucky	11/14/75	Fuel Adjustment Clause
Rural Electrification Administration (REA) Department of the Agriculture	6/18/75	Cost Separations Studies (A seminar conducted at the annual REA conference.)
Securities and Exchange Commission	2/28/75	Comment letter on Public Availability of Staff Letters of Comment and Related Correspondence

	Body (Congress, State Legislature, Government Agency	Date	Title or Description of Testimony or Presentation
.	Securities and Exchange Commission	3/03/75	Request for Public Hearing on Interim Financial Statement Proposals
.	Securities and Exchange Commission	3/14/75	Comment letter on Notice of Proposals to Increase Disclosure of Interim Results by Registrants
.	Securities and Exchange Commission	3/19/75	Comment letter on Revision of Rule 4-02 of Regulation S-X
.	Securities and Exchange Commission	5/20/75	Comment letter on Disclosure of Environmental and Other Matters of Social Concern
.	Securities and Exchange Commission	6/12/75	Comment letter on Involvement of Independent Auditors with Quarterly Financial Statements
.	Securities and Exchange Commission	6/17/75	Length of Comment Period for SEC Proposals
.	Securities and Exchange Commission	6/18/75	Testimony of R. D. Neary at Public Proceedings on Quarterly Financial Statement Data and Review Thereof by Independent Public Accountants
.	Securities and Exchange Commission	7/25/75	Comment letter on Minor Amendments to Regulation S-X (Re: Accounting Series Release Nos. 147, 148 and 149)
.	Securities and Exchange Commission	7/31/75	Comment letter on Projections of Future Economic Performance
.	Securities and Exchange Commission	12/08/75	Regulation S-X, Rule 9-05(b)(4) Schedule VIII
.	Securities and Exchange Commission	2/19/76	Comment letter on Amendments to Regulation S-X for Disclosure of Replacement Cost Data

Body (Congress, State Legislature, Government Agency	Date	Title or Description of Testimony or Presentation
. Securities and Exchange Commission	3/31/76	Comment letter on Disclosure of Details of Marketable and Other Investment Securities
. Securities and Exchange Commission	4/21/76	Request for Deletion of the Portion of Instruction H(f) of Form 10-Q Dealing with a Letter from the Registrant's Independent Accountant
. Cost Accounting Standards Board	1/30/75	Comment letter on Accounting for Acquisition Costs of Material
. Cost Accounting Standards Board	7/11/75	Comment letter on Composition and Measurement of Pension Cost
. Cost Accounting Standards Board	11/14/75	Comment letter on Allocation of Business Unit G&A Expense to Final Cost Objectives
. Cost Accounting Standards Board	12/05/75	Comment letter on Adjustment of Historical Depreciation Costs for Inflation
. Cost Accounting Standards Board	1/19/76	Comment letter on Distinguishing Between Direct and Indirect Costs (Staff Issues Paper)
. Cost Accounting Standards Board	4/26/76	Comment letter on Cost of Money as an Element of the Cost of Facilities
. Federal Trade Commission	5/14/75	Revision of Line of Business Program for 1974
. Department of Labor	12/19/75	Annual Reporting Requirements for Employee Benefit Plans
. Senator Cranston U.S. Senate	4/25/75	Letter clarifying our position on CASB Standard No. 409 (refers to 11/01/74 letter on proposed Standard No. 409)

	Body (Congress, State Legislature, Government Agency	Date	Title or Description of Testimony or Presentation*
.	Judiciary Committee, Alaska State Legislature	2/75	Ozark Separations and Settlements Impact on the State of Alaska
.	House Ways and Means Subcommittee on Tax Reforms Drafting of Tax Reform Proposals	9/08/75	Oral discussion concerning effect of tax reform proposals on livestock raisers

* Actual testimony not attached.

ERNST & ERNST
COMMONWEALTH BUILDING
LOUISVILLE, KENTUCKY 40202

November 14, 1975

Mr. H. Clyde Reeves, Chairman
Special Advisory Commission, Electrical
Utility Rates and Regulation
Capitol Building
Frankfort, Kentucky 40601

Dear Mr. Reeves:

Transmitted herewith is our report on fuel adjustment clauses in use by certain electrical utilities supplying consumers in the Commonwealth of Kentucky.

The utilities included, in varying degrees with respect to the scope of our work, are:

Louisville Gas & Electric Company
Kentucky Power Company
Kentucky Utilities Company
Union Light, Heat and Power Company
East Kentucky Power Cooperative
Big Rivers Electric Corporation
Henderson Municipal Power and Light
Owensboro Municipal Utilities
Tennessee Valley Authority

With respect to these utilities, and to the extent practicable within the scope of our engagement, we reviewed the fuel clauses in effect, the utilities' conformance with them, and the fuel procurement practices of the utilities. In addition, our report contains, as requested by the Commission, sections dealing with the overall nature of the fuel clause in the electric utility rate making process, the impact of the fuel clause on consumer bills, and our general recommendations concerning the desirability and feasibility of fuel clause standardization in Kentucky.

Our overall work plan consisted of initial meetings with designated individuals from each utility describing the nature of our assignment followed by two visits to the utilities' offices to obtain information regarding conformance to the fuel clauses and fuel procurement practices. The initial drafts of our findings were then reviewed with each utility to help assure that our findings and presentations were accurate and factual. We received good cooperation from the utilities and all responded to our request for comments, which comments, in our view, have improved the completeness and accuracy of this report.

A summary of our findings and recommendations follows:

FINDINGS

- Kentucky consumers compared to most other areas of the United States continue to enjoy lower overall electric rates as well as lower fuel cost components of those rates.

- Kentucky electrical utilities, notwithstanding the generally lower costs of fuel, and despite efforts to contain fuel costs, have not escaped the explosion of fuel costs which has occurred in the past two to three years.

- These cost increases have been reflected in the bills of Kentucky sonsumers through operation of fuel adjustment clauses.

- The Public Service Commission does not now require a standard fuel adjustment clause for electric utilities within its jurisdiction and, of course, there are electric utilities including TVA and municipal systems whose rates are not regulated by the Public Service Commission.

- Because of this, the fuel clauses of the utilities we reviewed vary in many respects. While each clause may have been conceived from a sound basis in fact, these variations, in our view, have made it more difficult for the Public Service Commission and the utilities to communicate to their consumers, and for the Commission to monitor the performance of the clauses.

- With respect to the conformance review, we categorize our overall results as favorable. In general, there is a concerted effort on the part of the utilities to monitor their own clauses, to perform cost and billing adjustment surcharge computations with accuracy and consistency, and to attempt to recover only increments in fuel costs as set out in their specific clauses. We did observe situations where utilities were, in our opinion, not conforming with their stated fuel clauses or were not consistent in the operation of their clauses. These are detailed in our report. In some instances, we may agree with the spirit of the treatment but reported nonconformance. We believe this type of nonconformance compounds the communications and credibility problem. Some problems regarding inaccuracies or inconsistencies were a result of the newness of the clause and dramatic changes in generation mix of the utilities. Correcting steps are already underway in some cases through self imposed measures by the utilities.

  Our major finding in this regard is that each utility has something slightly (or substantially) different to conform to. As we mentioned earlier, this makes the job of monitoring performance and communicating to consumers more difficult than would be the case if conformance were to a standard for all utilities.

- With respect to fuel procurement, our overall findings are favorable. Top management is involved in the fuel procurement process; there is evidence of hard bargaining for the best price and the comparative records support this observation; the utilities are, in our view, staffing their fuel procurement organizations adequately; and, finally, we found that the companies still have a strong incentive to seek fuel at the best price.

Regarding the last item, our evidence consisted of numerous examples of steps taken to reduce costs which could and would have otherwise been passed through the fuel clause to the rate payers.

RECOMMENDATIONS

- The practice of allowing fuel adjustment clauses in the rate schedules of electrical utilities operating in Kentucky should be continued.

- The Public Service Commission should consider the adoption of a standard fuel adjustment clause. Recognizing that a standard clause will not eliminate the reflection of differences among the utilities cost and physical characteristics; it can eliminate variations in at least the following elements of fuel adjustment clauses with little or no impact on consumers or the utilities:

    - Monetary Increment Used
    - Fuel Base Type
    - Lag Period
    - Specific Costs Included
    - Method of Computing Costs
    - Rate Schedule Coverage

- The Public Service Commission should also consider, as an adjunct to a standard fuel adjustment clause, sound reporting and monitoring procedures which would capture the benefits of a standard clause and enable the Commission to assure equity to both consumers and utilities through the fuel adjustment clause mechanism. Our report details the parameters we believe are important to a standard clause and our proposal contains samples of forms and procedures for reporting and monitoring.

We have enjoyed our association with you and your Commission, and with the utilities involved in the study. We hope that our findings will add to an already constructive and forward-looking approach to the provision of reliable and economic electric service to the consumers of the Commonwealth of Kentucky.

Very truly yours,

Ernst & Ernst

ERNST & ERNST
UNION COMMERCE BUILDING
CLEVELAND, OHIO 44115

April 26, 1976

Mr. Arthur Schoenhaut
Executive Secretary
Cost Accounting Standards Board
441 G Street, N.W.
Washington, D.C. 20548

Proposed Cost Accounting Standard (CAS) 414:
"Cost of Money as an Element of the Cost of Facilities Capital"

Dear Mr. Schoenhaut:

We are pleased to comment on the above-named proposal as published in the March 5, 1976 Federal Register.

We are in general agreement with the concept that the cost of capital should be recognized as an explicit cost of a contract, and that a contractor need not record this cost in his accounting records for financial statement purposes since this concept is not now recognized as a generally accepted accounting principle and may never be so recognized.

Cost of Capital Rate

We agree that a single cost of capital rate should be used for all contractors. We believe the proposed rate that takes into account the interest cost on five-year commercial loans is a better measure of a corporation's cost of capital than the Treasury Bond Rate (at which no corporation can borrow) that was suggested in an earlier Staff Draft. However, since investments in facilities usually are of a long-term nature, we feel a rate at which a corporation can borrow long-term funds, such as Moody's Aaa Corporate Bond Rate, would be more appropriate.

Cost of Capital Asset Base

We feel the cost of capital asset base to which the above rate is applied should reflect the total capital of the contractor needed to operate his business. We therefore support the Board in its resolution to study "techniques for measuring the costs allocable to contracts because of working capital investments."

Method of Application

We know the Board is concerned with the cost of implementing a new CAS and, consistent therewith, we recommend that the simplified method of allocating the entire cost of capital through the general and administrative (G&A) expense pool should always be an allowable alternative rather than "only where the contracting parties agree that the results are not likely to differ materially from those which would be produced under [the other prescribed procedure]." Since the Board has promulgated a standard on appropriate methods of allocating G&A expense, the refinement in accuracy achieved through a more complicated method of allocating the cost of capital is not meaningful given the nature of a single cost of capital rate.

Inflation

We believe the cost of facilities capital as used in this proposal will compensate a contractor for the cost of debt and equity used in financing his capital investment in a contract, but will not give recognition to the effects of inflation on a contractor's capital assets as was contemplated in proposed CAS 413. Inflation might be one of several factors that increase interest rates and create a higher cost of capital under this proposal. Recognition of this higher cost simply repays the contractor for his higher costs of funding the contract. On the other hand, we view the purpose of a standard on inflation to compensate a contractor for increases beyond his control in the costs of replacing assets he has utilized in producing goods under government contracts. We therefore support the Board's willingness to consider appropriate techniques developed by other authoritative accounting bodies "to deal in a practical manner with the impact of inflation" which we hope results in the Board allowing a contractor to explicitly recognize the effects of inflation on assets in CAS-covered contracts.

Implementation

Because this proposal advocates a new concept in contract cost recognition, we believe the Board should concern itself with the manner in which procurement agencies intend to implement this new concept. Although, as indicated above, we support this concept in principle, we are concerned that Government Contracting Officers or others who interpret the implementation of Cost Accounting Standards may attempt to lower contractors' profit rates because they misunderstand the purpose of this Standard. We therefore encourage the Board and its Staff to discuss this Standard with appropriate government procurement agencies and to reach an understanding on implementation that will motivate contractors and benefit the Government.

Other Matters

We believe the term "net book value," as used in this proposed Standard, means the historical cost of capital assets reduced by accumulated depreciation and amortization. Because a uniform understanding of

this term is necessary for a consistent application of this Standard, we recommend that the Board define "net book value" in Section 414.30.

We suggest the term "service center" not be used since the Board is now considering the development of a standard on this topic which could result in this term being used inappropriately in this Standard.

If you have any questions or wish to discuss any of our comments, please contact William E. Pritts at (216) 861-5000.

Very truly yours,

Ernst & Ernst

(Staff note: The other enclosures from Ernst & Ernst are retained in the committee files.)

(From the Washington Post, Sept. 16, 1972)

Audit Raises Tallies On Crime, Backs Dip

By Paul W. Valentine
Washington Post Staff Writer

Washington police undercounted thousands of crimes in the last three years, but the correct totals still support police claims that the overall crime rate has dropped, a special audit report released yesterday says.

The audit, ordered by Police Chief Jerry V. Wilson to offset charges that his department is accommodating Republican claims that crime has been cut here since President Nixon entered the White House, says that thousands of offense reports were lost, larceny values downgraded and FBI reporting guidelines ignored.

Chief Wilson was not immediately available for comment on the findings.

The city's crime rate has become an election-year issue, with White House spokesmen contending that President Nixon's get-tough attitude on crime and special infusions of federal money into anticrime programs here have reduced crime sharply.

Wilson testified in rosy terms at the Republican National Convention in Miami last month about shrinking crime totals, citing increased police, streamlined courts, improved street lighting and new narcotics addiction treatment programs as causes.

Meanwhile, a House Government Operations subcommittee headed by Rep. John S. Monagan (D-Conn.) has begun investigating Wilson's crime statistics and also the audit procedures of Ernst & Ernst.

Subcommittee spokesmen note that Julian O. Kay, head of Ernst's Washington office, is a key Republican fund raiser and treasurer of the "Victory '72 Dinner Committee," a unit of the Committee for the Re-election of the President. The "victory" dinner is scheduled here Sept. 26.

Ernst's $32,000, 64-page audit report, 14 days overdue, was issued to the police department yesterday.

It covers fiscal years 1970, 1971, and 1972, but does not go back to the period of the late 1960s when crime was reported rising rapidly.

Reported major crimes (murder, rape, robbery, aggravated assault, burglary, larceny of $50 or more, and auto theft) peaked in mid-1969 at more than 200 a day but have generally declined since.

Though the department undercounted the totals for 1970-72, the audit says, reported major crime nevertheless declined each year, in fact at a greater rate than police originally thought.

The report makes these comparisons:

	1972	1971	1970
Report by police	46,146	55,891	67,926
Corrected estimate	52,108	62,166	84,602

Police originally reported a 17.7 per cent decrease from 1970 to 1971 and 31.8 per cent from 1970 to 1972. The corrected or "adjusted" figures of the audit report show drops of 26.5 per cent and 38.4 per cent, respectively, for the same periods.

Auditors found 2,673 offense reports missing from police files (2,383 of them in 1970), 3,908 supplemental reports that they could not match with original reports and 5,745 that were filed in the wrong fiscal year.

These numbers were included in Ernst & Ernst's revised figures, and the firm recommended procedures to tighten future reporting.

The auditors also did a separate study of larcenies, considered the crime category most vulnerable to "fiddling," and found large percentages had been downgraded from larcenies over $50 to larcenies under $50, the dividing line between major and minor larceny. At the same time, there were relatively few instances of erroneous upgrading of larceny values, the report said.

The report estimated that of all the larcenies valued by police between $35 and $50, 26.5 per cent should have been valued above $50 in 1970, 13.2 per cent should have been valued above $50 in 1971, and 35.6 per cent in 1972.

The report also said the department ignores FBI guidelines requiring policemen to file a written report when they are unable to determine that a crime has been committed at a scene where they have been called to investigate.

"We recommend that a simplified report be designed and used for those cases," the report says.

In other recommendations, the report urged that police follow FBI Uniform Crime Report guidelines by using a complainant's value on stolen property rather than their own, unless the value is considered "obviously exaggerated."

(From the Washington Post, Oct. 26, 1972)

Police Auditors Criticized

By Paul W. Valentine
Washington Post Staff Writer

Ernst & Ernst, a nationally known accounting firm that recently affirmed the downward trend of Washington's crime rate, has a record of unreliability, slovenliness and plagiarism as police consultants, a House subcommittee report says.

According to testimony before the House Legal and Monetary Affairs Subcommittee last year, Ernst employees:

• Prepared an incomplete, tardy and never used survey of police needs for New Mexico state law enforcement planners in 1969, at a cost of $35,541.

• Plagiarized large portions of existing government publications in preparing two procedures manuals for state and local enforcement planners in Louisiana in 1969 and 1971, for a total fee of $27,000.

• Worked on a wide assortment of consulting contracts in Indiana in 1969, 1970 and 1971: the contracts totaled $286,000 in fees for Ernst, and most were awarded without competitive bidding. Employees developed such a cozy relationship with Indiana enforcement officials, the report said, that some helped the state prepare its testimony before the House Subcommittee, and at least one employee was provided state office space and given free transportation in a state airplane.

The criticisms are contained in a report issued last May by the Subcommittee, headed by Rep. John S. Monagan (D-Conn.).

The report is a review of practices by the federal Law Enforcement Assistance Administration (LEAA) in financing local police improvement projects. It is especially critical of what it calls "consulting abuses" by private firms providing inadequate assistance under LEAA-financed contracts and singles out Ernst & Ernst as a prime example.

Ernst accountants completed an extensive $32,000 audit of the Washington metropolitan police department's crime statistics last month generally supporting claims of Police Chief Jerry V. Wilson that serious crime has plunged 30 per cent here since mid-1969.

The reported crime drop has become an election campaign issue this fall with Republican spokesmen claiming that Nixon get-tough policies and special federally financed anti-crime programs turned the crime tide in the nation's capital after the reported upsurge of crime during the Johnson administration of the middle and late 1960s.

Chief Wilson denying insinuations that his department deliberately under-reported crime to fit Republican strategy, ordered the Ernst & Ernst audit early this year as a means of confirming departmental integrity.

The 64-page audit report, issued Sept. 15, said police under-counted thousands of crimes during the last three years, but the corrected totals still showed a sharp decline in overall crime for the period.

Monagan's Subcommittee has launched an investigation of both the crime statistics here and Ernst's auditing procedures. It has noted among other things that the chief of Ernst's 100-employee Washington office, Julian O. Kay, is a key Nixon re-election official and treasurer of the "Victory '72 Dinner Committee," which coordinated a series of fund-raising galas around the nation Sept. 26.

Ernst officials would not discuss details of the police audit with this reporter. Thomas J. Linahan, project manager for the audit, cited company rules prohibiting revelation of information without the client's authorization. Chief Wilson has refused to grant the authorization.

By the same token, officials at Ernst's corporate headquarters in Cleveland also refused to respond to the Monagan Subcommittee criticisms of Ernst's performance in New Mexico, Louisiana and Indiana.

Discussion of specific contract work would "violate client confidentiality" as set out in industry ground rules, said Ernst executive assistant George Hauer yesterday. Written authorization from each client would be required for him to talk, he said.

He declined to talk further except to say that the criticism that the Ernst & Ernst staff lacks police experience is "a lot of crap."

Hauer, a former FBI agent himself, said at least one staff worker assigned to the Washington police audit, for example, is a former Ohio State highway patrol official.

This was an apparent reference to Duane R. Kinsey, a 41-year Ohio patrol veteran, listed by Ernst as a key member of its project team assigned to the Washington police audit.

Ernst & Ernst time sheets obtained by The Washington Post show 15 employees worked at various times on the audit, but Kinsey's name does not appear on the sheets. A source close to the audit project said the sheets obtained by The Post were complete.

They show the 15 employees, including Kay and Linahan, worked a total of 1,877 man hours during several months of the audit, ranging from 650 hours by one auditor to two hours by another.

The audit report, issued 14 days overdue last Sept. 15, was hailed by police officials here as upholding their claim that crime has declined in the last three years.

Unpublished police statistics show that almost 40 per cent of citizen complaints for major crimes here do not result in written reports by investigating officers and thus never are reflected in the official, published crime figures.

Many of these complaints turn out to be baseless, but an undetermined number are actual crimes, according to on-scene observations and interviews with rank and file policemen by The Post.

Independent statisticians here say that as long as there are so many unknown factors, it is impossible to determine if the crime rate is rising, falling or holding steady.

Chief Wilson contends that virtually all the unreported complaints are baseless or unfounded and that the practice of not reporting such cases has been done here for many years and is common in other cities.

The Ernst audit covered only fiscal 1970, 1971 and 1972, and thus made no comparisons of published or unpublished statistics prior to that time.

In the Monagan Subcommittee report, New Mexico state law enforcement planning agency former director James B. Grant is quoted as saying the 1969 Ernst survey of police needs there was inadequate and conducted in part by employees with no prior police experience. In addition to being received too late for use, the survey "was incomplete, unreliable and of very limited value," Grant said.

In the Louisiana case, the Monagan report cited what it called plagiarisms from existing publications by Ernst in preparing two state law enforcement manuals. "At least 108 of 128 pages in the 1969 manual and 104 of the 156 pages in the 1971 manual were plagiarisms or paraphrasings of government publications," the report said.

In Indiana, the report said, "LEAA planning grants have become captives of outside consultants. The involvement of consultants, particularly Ernst & Ernst, extends beyond mere plan preparation, almost to the point where it has become ludicrous."

(From the Wall Street Journal, August 20, 1976)

Ernst & Ernst Urges Accounting Method Modeled on LIFO

* * *

Firms Could Lower Taxes By Adjusting Assets' Value for Inflation

By a WALL STREET JOURNAL *Staff Reporter*

NEW YORK—A major accounting firm proposed that corporations be permitted to adopt a relatively simple form of "inflation accounting" that would reduce the effective rate of income taxes they pay.

Ernst & Ernst, a Cleveland member of the "big eight" public auditing firms, said the proposal was being made to the Financial Accounting Standards Board, which sets rules for the profession, and to the Securities and Exchange Commission.

Because of the rapid rate of inflation in recent years, corporations and the accounting profession have been debating possible changes in the way companies report on their financial condition. The key problem involves depreciation of corporate assets.

Historic Cost

Traditionally, companies report their assets on the balance sheet at their historic cost, the original price. This is reduced each year by depreciation, an effort to show how funds are being built up to pay for replacement of the asset when it wears out. The depreciation charge comes out of corporate earnings and reduces reported profit.

Because of inflation, depreciation at a historic rate doesn't allow for higher prices to be paid when an asset is replaced. Inadequate depreciation charges, in effect, overstate corporate profit. Therefore, many corporations argue, they are paying corporate income taxes at an artificially high rate.

A variety of proposals for dealing with this problem have been under discussion in the accounting profession. Most, the accountants concede, are complex and would be difficult for the users of corporate reports to understand.

Replacement-Cost Footnotes

Also, under a recent SEC order, the country's larger corporations will begin with this year's reports telling stockholders how much it would cost at today's prices to replace their factories and equipment. This will be done in footnotes to the financial reports and won't affect reported earnings.

Ernst & Ernst proposed adapting a form of accounting widely used currently for valuing inventories to other corporate assets. The inventory accounting, called last-in, first-out, or LIFO, does largely offset price changes that come between the time inventory is acquired and the time it goes into corporate sales by basing the cost of goods sold on the most recent prices for raw materials and other inventory items.

The firm urged that LIFO accounting be used for all corporate assets by means of price indices to be officially authorized by a governmental agency.

The effect would be to increase depreciation charges, which in turn, would reduce reported earnings and the taxes paid on them. A corporation would continue to use historic price information on its balance sheet. The difference between depreciation at historic prices and inflation-adjusted depreciation charges would go into a special shareholders' equity account.

HASKINS & SELLS

CERTIFIED PUBLIC ACCOUNTANTS

EXECUTIVE OFFICE

1114 AVENUE OF THE AMERICAS

NEW YORK, NEW YORK 10036

April 30, 1976

The Honorable Lee Metcalf
United States Senate
Subcommittee on Reports,
Accounting, and Management
Washington, D. C. 20510

Dear Mr. Metcalf:

In accordance with your letter of April 8, 1976, we are enclosing herewith certain material which you have requested.

In selecting this material, we have interpreted your request to encompass any situation where our Firm, through its partners or other members of the organization, has expressed its views with regard to accounting, auditing, or tax matters, which have general applicability and deal with matters of principle. We have excluded, therefore, communications relating to specific questions which have arisen in the course of our professional practice which relate to specific clients. We have also excluded any material which may have been compiled by a member of our Firm who was acting as a representative of or spokesman for the American Institute of Certified Public Accountants or another professional organization on the grounds that you have obtained this material directly from such organization.

The following is an index to the copies included in this submission:

A. Securities and Exchange Commission - File No. S7-579, Disclosure of Certain Replacement Cost Data in Notes to Financial Statements - February 3, 1976

B. Securities and Exchange Commission - File No. S7-589, Proposed Guides 61 and 3 - November 26, 1975

C. Securities and Exchange Commission - File No. S7-542, Comments on Commission's Notice of Alternative Proposals Regarding Disclosure of Interim Results in Financial Statements - June 16 and April 8, 1975

D. Securities and Exchange Commission - File No. S7-561, Comments on proposals to implement the Statement by the Commission on the Disclosure of Projections of Future Economic Performance - July 30, 1976

E. Cost Accounting Standards Board - Adjustment of Historical Depreciation Costs for Inflation - December 8, 1975

F. Subcommittee on Oversight Procedures - Testimony on various state and federal government regulations and the related reports required thereby - by Curtis H. Cadenhead, Jr., Partner of Haskins & Sells - February 12, 1976

G. Joint Committee on Internal Revenue Taxation - Re: H.R. 11920 - A Bill to terminate the use of exchange funds as a means of escaping income taxes on realized capital gains - March 15, 1976

H. Committee on Finance, United States Senate - Re: H.R. 10680 Renegotiation Act Amendments of 1975 - March 19, 1976

I. Federal Power Commission - Re: Docket No. RM75-13 - Written Comments of Haskins & Sells Re Inclusion of CWIP in Rate Base - March 1, 1976

J. House of Representatives - Re: Private Letter Rulings - July 14, 1975

K. Committee On Ways And Means, U.S. House of Representatives - Testimony of John W. Gilbert, Partner, Haskins & Sells, Certified Public Accountants, on Private Letter Rulings - July 11, 1975

L. House of Representatives - Re: DISC Repeal - October 1, 1975

M. Committee on Ways and Means, U.S. House of Representatives - Re: H.R. 11920 - A Bill to terminate the use of exchange funds as a means of escaping income taxes on realized capital gains - March 15, 1976

N. Pennsylvania Public Utility Commission - Testimony of John F. Utley on inclusion of Construction Work in Process in the rate base, R.I.D. NO. 221 - January 20, 1976

If further information is desired regarding this matter, please advise.

Very truly yours,

Thomas B. Hogan

Thomas B. Hogan
Partner

Enclosures

(Staff note: The enclosures from Haskins & Sells are retained in the committee files.)

REPORT OF THE TRUSTEE

of

Equity Funding Corporation of America

Pursuant to Section 167 (3)
of The Bankruptcy Act
[11 U.S.C. §567(3)]

ROBERT M. LOEFFLER
Trustee

O'MELVENY & MYERS
Of Counsel

October 31, 1974
(Second Printing)

PART TWO

THE FRAUD AT EQUITY FUNDING

I. OVERVIEW AND SUMMARY

When the shocking news of the problems at EFCA first came to the public's attention in April 1973, the fraud at the Company was almost a decade old. In the months which have elapsed since those initial revelations, much has been written about the fraud and its history. Despite all of the commentary, three basic points remain obscured.

First, the fraud at EFCA was essentially a *securities* fraud. While much attention has been focused on the insurance aspects — especially the manufacture of bogus policies — that activity was merely one part of a much larger stock fraud that began at or before the time of EFCA's first public offering in 1964. This scheme appears to have been initially motivated and then sustained throughout the decade of its existence by an obsessive desire on the part of its participants to inflate and keep aloft the market price of EFCA's common stock. It is not incidental that the originators of the conspiracy were also the major holders of the Company's stock, for one result of the fraud was their personal enrichment. It may well be, however, that as time went on pride and vanity played as great a motivating role as greed for many of the participants.

Second, theft and embezzlement seem to have been a relatively small part of the fraud.* Most of the so-called "missing" assets never in fact existed or were dissipated in the Company's continuing operating losses.

Third, the fraud was relatively unsophisticated in both design and execution. It was neither comprehensively planned nor systematically developed. Rather, its various individual elements were created on an ad hoc basis, as need dictated or opportunity presented itself, and little attempt was ever made to integrate these various elements with one another. In order to coherently describe the fraud,

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* The thefts and embezzlements known to the Trustee are described at pages 129-133.

this report has attempted to order and structure its elements into a number of broad categories. But this organized presentation really belies the true helter-skelter, hand-to-mouth nature of the fraud.

Moreover, notwithstanding some publicized accounts to the contrary, the fraud was not the brainchild of computer-age financial wizards. It was to a great extent simply a pencil fraud, perpetrated by means of bogus manual accounting entries, with virtually no support for those entries in many cases. That the fraud persisted undetected for so long is attributable to the audacity and luck of its perpetrators and, just as importantly, to the glaring failure of the Company's auditors to perform properly the obligations which they had undertaken.

The EFCA fraud was carried out principally by inflating the Company's reported earnings, largely through recording nonexistent commission income in EFCA's books and records.* This practice appears to have begun at least as early as 1964, in anticipation of EFCA's first public offering of common stock, and to have continued on an increasing scale until the fraud was discovered in early 1973. Since the majority of bogus income was booked in connection with the Company's funding business, that aspect of the EFCA fraud is referred to in this report as the "funding fraud."** (It should be noted, however, that nothing about the funding business made it inherently subject to fraud.)

The basic concept of the funding fraud is easily grasped. The bulk of EFCA's real income during the early period of the Company's history derived from commissions earned on sales of "Equity Funding Programs," a combination of mutual fund shares and life insurance policies which EFCA helped to pioneer. Beginning at least with the first known bogus entries in 1964, and each year thereafter until the Company's collapse in 1973, the amount of commission in-

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*Appendix B to this report contains reproductions of the consolidated financial statements for EFCA and its subsidiaries which were published in annual reports to shareholders from 1964 to 1971. The annual report for 1972 was at the printer when the fraud was discovered and, accordingly, a reproduction of a printer's proof of the financial statements for that year is also included.

**See "The Funding Fraud," beginning at page 13.

come which EFCA earned in connection with such sales was inflated in the Company's financial statements. Over the years, the amount of bogus income reported by this means alone totalled in excess of $85 million.

The funding fraud had a number of attributes which made it particularly attractive as a method for reporting bogus income, not the least of which was its operational simplicity. It required only manual entries in the Company's books and records to produce the precise amounts of earnings inflation desired. No effort was made to provide underlying documentation to back up the entries, nor was any attempt made to conform EFCA's individual funding customer accounts to the fictitious entries in the books and records. Hence, the funding fraud was easily perpetrated by a small group of people, and this minimized the risk of its discovery.

Through 1967, the funding fraud appears to have been sufficient to boost the earnings of EFCA to the level desired by those managing the scheme. Despite its more attractive attributes, however, the funding fraud had an inherent characteristic which limited its usefulness as a means of inflating income. Because of the manner in which EFCA's funding programs operated and were accounted for on the Company's books, each dollar of bogus income produced through the funding fraud resulted in a dollar increase in an asset called "funded loans receivable," representing amounts supposedly borrowed by customers and ultimately due for repayment to the Company.* EFCA's management hardly objected to an increase in the Company's reported assets. But as the inflation of funded loans receivable increased, it became more and more difficult to support the patently excessive figures to the satisfaction of even EFCA's easily-satisfied auditors. Moreover, while the funding fraud made EFCA appear to be more profitable than it really was and made it appear to hold larger assets than it really held, it did not supply any cash to the Company. As time went on, EFCA's cash needs became severe, most notably because of continued operating losses.

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* See "The Equity Funding Concept," at pages 13-14, and "Accounting Treatment for EFCA's Funding Program," at pages 18-23, for a more comprehensive explanation of EFCA's funding business and the accounting therefor.

Beginning around 1968, as a result of these problems, the EFCA fraud broadened beyond the simple device of funding account overstatements and inflation of commission income. One device employed by the conspirators was designed to help ease the cash needs of the Company, and also to reduce the burgeoning funded loans asset and thereby permit the reporting of still more fictitious income through the funding fraud. This device involved borrowing funds without recording the amounts borrowed as liabilities on the Company's books. Sometimes this was done simply by not recording the sources of the funds at all, and on other occasions by incredibly complicated bogus transactions which wound their way through numerous subsidiaries, foreign and domestic. However it was done, the borrowed funds were applied to reduce the funded loans asset as though Equity Funding Program participants had retired their loans by cash payments. The conspirators referred to funds brought into the Company in this manner as "free credits."

The expansion of the EFCA fraud after 1968 involved not only "free credits" but a diverse variety of other frauds, some simple and some complicated. For example, a sham sale of supposedly valuable future commissions, which EFCA owned, to a foreign shell controlled by the conspirators resulted in the inflation of income by $17.2 million in 1969. Because many of these schemes in some manner concerned foreign transactions and subsidiaries with which the Company purported to be involved from 1968 to 1970, this period in the history of the fraud is characterized in this report as its "foreign phase."*

Ultimately, these various schemes proved insufficient to generate the amount of bogus income desired by the conspirators. An "insurance phase" of the fraud developed to fill this void.** The fictitious record of growth which resulted from the funding overstatements had facilitated expansion of the Company's operations through acquisitions financed by a series of debt offerings and by inflated EFCA stock.† As a result, EFCA was transformed from a

* See "The Foreign Phase of the Fraud," beginning at page 45.

** See "The Insurance Phase of the Fraud," beginning at page 77.

† The period of acquisition is chronicled in Report of the Trustee of Equity Funding Corporation of America pursuant to Section 167(1) of the Bankruptcy Act (Feb. 22, 1974) (hereafter "Report of the Trustee") at pages 7-12.

simple marketing organization into a life insurance-based conglomerate. Most important among EFCA's insurance subsidiaries was Equity Funding Life Insurance Company ("EFLIC"), acquired in late 1967. A major part of EFLIC's insurance business involved "reinsurance" — in effect, the resale of insurance policies to a second insurance company. It was through EFLIC's reinsurance operations that the conspirators perpetrated the most celebrated aspect of the EFCA fraud.

The integration of EFLIC's reinsurance operations into the EFCA fraud evolved in stages. In 1968, EFCA negotiated a release from the terms of an exclusive sales agreement it had with Pennsylvania Life Insurance Company ("PLC") in order to permit EFCA to market insurance policies underwritten by EFLIC. To secure the release, EFCA committed itself to reinsure a large amount of insurance with PLC over a three-year period. Early in 1968, it became clear that EFCA would not be able to fulfill that commitment through its regular business, a prospect which was disturbing to EFCA's management for a number of reasons. To solve this problem the Company decided to issue what it termed a "special class" of insurance, consisting of policies issued to its agents and employees on which it paid all or part of the first year premium. These policies were reinsured with PLC, but the nature of the business was not disclosed.

"Special class" insurance was followed in 1969 by the implementation of a new scheme to help EFLIC meet its reinsurance commitments and "production goals" set by the conspirators. Pending business — that is, applied-for insurance which still required approval by the underwriting department and payment by the applicant — was posted on the Company's books as if it were in-force and paid-up. This pending business was reinsured with other companies, despite the recognition that much of it would never legitimately become effective.

The Company had difficulty with PLC because of the high lapse rates on the "special class" business which had been reinsured. To avoid a suspiciously high lapse rate on reinsured pending policies, the conspirators arranged for the Company to pay renewal premiums on that portion of the pending business which never became

effective. It was but a short step from this to the outright creation of wholly bogus policies, a step that was taken the following year.

The conspirators began in 1970 to record wholly fictitious insurance in order to lend an illusion of production to the Company's operations, and then to reinsure those policies in order to generate needed cash. This practice continued through 1971 and 1972 at an increasing pace. The conspirators thus found a device which they hoped could assist the funding fraud in augmenting the Company's reported earnings on a sustained basis.

But the insurance phase of the fraud created monumental difficulties. The most immediate of these was a serious cash flow problem. Under the Company's reinsurance arrangements, EFLIC received a significant cash payment from its reinsurers at the time policies were reinsured. In succeeding years, however, EFLIC was required to forward to the reinsurers the renewal premiums it received from policyholders. In the case of the bogus policies, of course, there were no policyholders. Consequently, the Company had to pay these renewal premiums itself. The conspirators tried to meet this cash need by reinsuring more bogus policies, but this only made next year's cash flow problem worse. Thus, in 1972 EFLIC had a negative cash flow of $1.7 million in connection with its bogus reinsurance operation.

A second difficulty resulted from the manner in which insurance sales were accounted for on the Company's books. EFCA's general insurance agency subsidiary, EFC-Cal, earned commissions on the sales of EFLIC policies, and received the insurance premiums paid in connection with these policies. The premium amounts which EFC-Cal owed EFLIC, after its commissions were deducted, were reflected in an "inter-company account" between the two subsidiaries. Fictitious insurance resulted in a growing imbalance in this inter-company account because premium amounts purportedly due to EFLIC from bogus business were recorded on EFLIC's books but not on those of EFC-Cal. To cope with this problem, the conspirators had to create more and more fictitious assets.

The conspirators were still grappling with these problems when their house of cards collapsed in March and April of 1973. The col-

lapse was by then inevitable, a reality which the perpetrators of the fraud refused to face. Even as the fraud came apart at its seams, they tried to respond to the situation with further intrigue and deceit, but their time had at last run out.

In the end, the results of the fraud were massive. From 1964 through 1972, at least $143 million in fictitious pre-tax income was reported in the Company's financial statements.* During the same period, the total net earnings reported by EFCA amounted to just over $76 million. Although the Company thus was never actually profitable, it appeared to flourish and its securities attracted thousands of investors. The story of the fraud at Equity Funding, which has had tragic consequences for many, is told in greater detail in the following chapters of this report.

* See Report of the Trustee at page 38.

PART FOUR

CONCLUSIONS

I. SETTING THE RECORD STRAIGHT

In the wake of the highly publicized EFCA scandal, a number of misconceptions about the fraud appear to have gained wide acceptance. Hence, there may be some value at the outset of this final chapter in specifically setting the record straight with respect to three such misconceptions.

A. **EFCA Was Not a Corporate Giant Looted by Insiders.**

The most frequently asked question about the EFCA fraud probably is, "Where did all the money go?" This question rests upon two assumptions: (1) that EFCA was a prosperous corporate giant with substantial real income and assets; and (2) that the fraud consisted of stealing huge amounts of those sums. Both assumptions appear to be incorrect.

First, it is now known that EFCA never was a true corporate giant. When the fraud was discovered, EFCA proved to be a "paper giant." While several of its subsidiaries had value and were untainted by the fraud, as an overall matter the Company's reported statistics were mostly a fraud. Simply put, EFCA never had the assets it reported; never had the revenues; never had the sales; never had the net worth; and never made the profits. Thus, despite all of its acquisitions, the Company appears to have always been relatively small, devoid of equity, and totally unprofitable.

It is now apparent that EFCA sustained operating losses for years in its home office, insurance and marketing operations, and probably in the financing of its funding business as well. On a consolidated basis, deficits from the Company's losing operations clearly exceeded total earnings from its few profitable subsidiaries. Moreover, the most profitable subsidiaries were but recently acquired: Bankers in 1971 and Northern in 1972.

Thus, it appears that the only way EFCA was able to report any net earnings at all was through the fraud. As the following table demonstrates, from 1964 to 1972 the Company reported net earnings

of $76 million. During the same years, the fraud generated at least $143 million of bogus income,* more than $114 million of which came from funding and insurance. Without this bogus income, EFCA undoubtedly would have reported a loss in every year of its operations and, for all years taken together, it would have reported aggregate net operating losses in the millions of dollars.

COMPARISON OF ESTIMATED BOGUS FUNDING AND INSURANCE INCOME TO REPORTED NET EARNINGS**
(1964-1972)

	Bogus Funding Income	Bogus Insurance Income	Minimum Gross Income From Fraud	Reported Consolidated Earnings†
1964	$ 361,000	$ 0	$ 361,000	$ 389,467
1965	1,068,000	0	1,068,000	795,944
1966	3,155,000	0	3,155,000	1,177,355
1967	3,549,000	0	3,549,000	2,530,380
1968	5,152,000	0	5,152,000	7,825,857
1969	17,200,000	350,000	17,550,000	10,911,632
1970	15,600,000	4,000,000	19,600,000	11,715,625
1971	17,900,000	10,000,000	27,900,000	18,192,000
1972	21,000,000	14,667,000	35,667,000	22,617,000
TOTAL	$85,345,000	$29,017,000	$114,412,000	$76,155,260

It should be noted that this table shows only the estimated amounts of bogus income from funding and insurance. A sizeable amount of other bogus income was generated over the course of the fraud through a grab-bag of accounting "dirty tricks" which have not been fully explained in this report because of their relative insignificance. Some examples are briefly described later in this chapter.††

From the foregoing, it should be apparent that the first assumption underlying the myth of the looted giant is false: There was no real giant to loot. It also appears that the second assumption is false. Despite the fact that large amounts of cash did come in to EFCA

* See Report of Trustee at page 38.

** Figures shown are estimated minimum amounts.

† See financial statements in Appendix B, beginning at page 155.

†† See page 140.

through borrowings, no evidence has yet been found that the conspirators drained the Company's treasury. It is probable that substantially all of the cash left over after paying off loans and making acquisitions was exhausted by operating losses, although the amount of these losses cannot be determined because of the dismal state of the Company's records. With the exception of the three-quarters of a million dollars in embezzlements and peccadillos reported in Part Three of this report,* it does not appear that there was significant looting. This is not to say that the conspirators were not enriched by the fraud. They received generous emoluments, and the ringleaders realized hundreds of thousands and, in two instances, millions of dollars in wrongful profits from stock sales.** But they do not appear to have dipped directly into the till for large sums.

This conclusion is supported by all of the available evidence. First, the Trustee's lawyers and accountants have scrutinized EFCA's books and records in painstaking detail over the past year and a half. A large share of this enormous amount of time was spent on a balance sheet audit as of April 5, 1973, the results of which have already been reported by the Trustee.† Equally large amounts of time have been spent studying available historical records maintained by the Company and its former auditors, and reviewing the hundreds of files maintained by the conspirators themselves.

Throughout this intensive search, a special effort has been made to look for clues of looting. For example, sample tests of cash receipts and disbursements were made for selected periods of the Company's operations. In addition, some individual transactions have been analyzed for hints of theft. Although many questions are raised by the records, none appear to point in the direction of massive looting by the conspirators.

Evidence taken from more than 100 witnesses —including many of the fraud participants themselves—also buttresses this conclusion. The Trustee's lawyers have taken or reviewed testimony from most of the key conspirators. In addition, dozens of other persons who might know of such looting if it in fact took place have been inter-

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* See pages 129-133.
** See pages 121-126.
† See generally, Report of the Trustee.

viewed. None of this evidence indicates that any substantial sums of money were embezzled from the Company other than as described in this report. Of course, the possibility of substantial theft remains, especially in view of the unlikelihood that a conspirator guilty of looting would admit to it and the impossibility of determining the actual cash flow in and out of EFCA over the years. Consequently, the Trustee intends to pursue this possibility in the context of contemplated litigation and otherwise. Based upon presently available information, however, it does not appear that the EFCA fraud involved large-scale looting of the sort imagined by those who ask where all the money went.

B. **The Fraud Was Not a Brilliant Computer Fraud.**

A great deal has been written about the EFCA fraud. Much of the literature seems to characterize the fraud as the brilliant brain-child of "with-it" business and computer wizards. As a result, many readers may have the impression that the EFCA fraud was carefully planned and executed with a high level of precision and sophistication which baffled the world until it was finally discovered in April 1973. Nothing could be farther from the truth than this misconception.

First, EFCA appears never to have had people experienced in management at its top executive level. The four founders, for example, were all salesmen by background. Two of these men — Michael Riordan and Stanley Goldblum—dominated the management of EFCA as long as they were associated with it. Neither had any experience in business outside of sales before they started the Company. With a few exceptions, other "top executives" tended to be either lower-level accountants or lawyers — none of whom had significant business experience prior to the time they were put in charge of EFCA. Thus, Jerome Evans had a variety of bookkeeping jobs prior to becoming the chief financial officer of the Company, but it is safe to say that he never managed more than a handful of people before he was put in charge of EFCA's operations. Samuel Lowell, while he worked at one time for a big-eight accounting firm, also seems to have had no prior management background. Fred Levin was a lawyer with the Illinois Insurance Department when he was hired by Presidential, and he too had little or no executive experience before assuming a major management role at EFCA. Furthermore,

the top managers — who tended to be the top fraud participants — were primarily assisted in running both EFCA and the fraud by a growing corps of vice presidents in their 20's and early 30's most of whom also do not appear to have held any previous management positions. In short, the majority of EFCA's managers appear to have been inexperienced men, lacking in seasoned business judgment, who played at high finance — and failed miserably in the process.

Not only did these men fail at running the Company; in fact, they did not run the fraud any better. As this report demonstrates, there simply was no "grand scheme." Every step of this fraud was jerry-built — one misstep requiring another more complicated misstep to conceal all that had gone before. It is true that the conspirators can sometimes be credited for a degree of inventiveness in extricating themselves from near hopeless situations. On the whole, however, their helter-skelter, hand-to-mouth efforts demonstrate a striking lack of analytical insight and forethought. Indeed, some of the devices used to further or conceal the fraud are totally devoid of economic sense and seem to be in almost open defiance of generally accepted accounting principles and auditing standards. For example, although the conspirators were creating bogus income both from the insurance operation and from funding, they never figured out how to effectively coordinate the steps of the fraud. This failure created growing imbalances in inter-company accounts which might have been eliminated by effective administration and a degree of farsightedness. Moreover, from the outset, no one appears ever to have given serious thought to a way out of the scheme.

Oddly enough, the slipshod character of much of the fraud may be a reflection of the attitude of some conspirators who appear to have looked upon the fraud as a game. The curious flippancy of the conspirators is illustrated by a sheet of game instructions given to Samuel Lowell by Arthur Lewis which was found in a Lowell file entitled "Kudos." This document explains how to play "Sam-O-Wits." The "player" is instructed to reply to questions concerning EFCA's financial statements by saying, "That was caused by a . . .," followed by his choice of one word from each of three columns on the sheet. The "player" is admonished to "emphasize the third word" and, if asked to explain in greater detail, he is told to "comment that the

subject is so complex and technical that it took two years to understand it." The three columns are as follows:

Column 1	*Column 2*	*Column 3*
Complicated	Phase III	Adjustment
Complex	Commission	Reinstatement
Preliminary	Persistency	Provision
Convoluted	Morbidity	Experience
Favorable	Recapture	Retrocession
Mature	Actuarial	Fluctuation
Consolidated	Non-Refund	Ruling

Least of all was this a modern "computer" fraud. The computer did not even contain complete records for EFCA's legitimate business — let alone the fraud. For example, the critical records for the Company's legitimate funding business were kept on microfiche, and were dealt with entirely by hand. The only record for funding business kept on the computer was an inventory of funding accounts. Entries to book fictitious income were made by manual additions to the books and records in total disregard of the Company's computer print-outs. And in insurance, although reams of print-outs were created to support the fraud, there was little or no underlying detail for these print-outs. Hence, while the computer may have generated a paper "screen" for some aspects of the fraud, in fact the role it played was no bigger or more complicated than that played by the Company's adding machines.

C. **The Fraud Was Not an Insurance Fraud.**

Probably because they were discovered first, the insurance aspects of the EFCA fraud have received the most publicity, and the scandal has frequently been characterized as an insurance fraud. However, as this report has shown, the insurance activity was merely one particular phase of a much larger stock fraud that began at or before the time of EFCA's first public offering in 1964. The fraud was designed to pump up the value of the Company's stock by systematically inflating EFCA's reported earnings through every means available to the conspirators.

The funding and insurance devices contributed the most bogus income to EFCA's reported earnings, and thus had the biggest impact

upon the Company's earnings. Although this report has focused upon these revenue-inflation devices, many others were used as well to keep EFCA's stock flying high. For example, in 1968 — in addition to the estimated $5.5 million of bogus funding income recorded — approximately $3 million of bogus revenue was generated by recording as income in that year the difference between market value and cost of various securities, even though these securities were still held by the Company and had not been sold. Another oft-used trick involved the "sale" of future income from some aspect of EFCA's business for a promissory note which was to be paid-off out of that income as it was received. In several instances, although the "sale" amounted to a mere financing arrangement, the full amount of the note was improperly recorded as income in the year of the transaction. Another ploy involved overstating the percentage of completion on real estate projects in order to recognize a greater amount of income than was proper. Still another device involved improperly recognizing more than $1 million of income earned by a recently acquired subsidiary, despite the fact that the acquisition was rescinded during the year the income was recognized.

The list of bogus income creating devices is a long one, and all the examples may not yet be known. The point is that all of these devices had as their goal the fraudulent inflation of the market price of EFCA's common stock. Hence, as this report has tried to demonstrate, the primary impact of the fraud was upon holders of EFCA securities and others who were misled by the Company's fraudulent financial statements. There was no impact upon its insurance policyholders — and relatively little impact upon EFLIC's reinsurers. Thus, insurance was merely the last phase of what should now be seen as a classic stock fraud.

II. HOW DID THE FRAUD LAST SO LONG?

If the EFCA fraud was truly as haphazard and disconnected as it has been portrayed in this report, then it is legitimate to ask how it persisted for a decade without detection. Obviously a number of factors contributed to the longevity of the conspiracy. Foremost, of course, were the lies, audacity and luck of the ringleaders. Of almost equal importance was the surprising ability of the originators

of the fraud to recruit new participants over the years. Closely related was the moral blindness of those participants, including several who helped execute the scheme and then left the Company, but remained silent. It is noteworthy that in the end, the fraud was undone by the spite of a former conspirator who had been terminated, not by anyone's conscience pangs.

The foregoing factors explain how the conspiracy was sustained for so long from within the Company. Responsibility for failing to detect the fraud rests primarily with the accounting firms retained to certify the financial condition of EFCA and its subsidiaries. As this report makes clear, the fraud took place "on paper" — in the books and records of the Company and some of its subsidiaries. Aside from the perpetrators themselves, only the auditors, as part of their annual examinations, had regular opportunities to review these books and records. In the Trustee's judgment, had the auditors properly discharged their obligations, the fraud would have been caught years ago.

A. **The Parent's Auditors.**

From 1961 to 1970, EFCA and most of its subsidiaries were audited by Wolfson Weiner. There is strong evidence that several of the accountants in charge of these audits were aware of or suspected the fraud and cooperated in its concealment. Such a conclusion seems irresistible to the Trustee if only because Wolfson Weiner's performance was so manifestly incompetent for so many years as to be inexplicable on any other basis.

First, EFCA's books and records were a literal mess over the entire life of the fraud, and it seems reasonably clear that the Company never had adequate internal controls in many areas, including its funding operations. Thus, it is difficult to see how Wolfson Weiner performed any audits at all. Had the auditors done their job by requiring management to maintain orderly records and to develop adequate control procedures as a condition of annual certification, it would have been impossible to get the funding fraud off the ground.

Equally important, Wolfson Weiner failed in numerous respects to conduct its examinations in accordance with generally accepted

auditing standards. The omissions and errors were legion, and many examples are recounted in the body of this report. Four prominent instances will serve to illustrate this essential point: Evans' first bogus commission entry in 1964;* Templeton's problems with funded loans receivable in 1968;** the treatment of the net trail commissions in 1969;† and the patently inadequate support for funded loans at year end 1972.†† Substantial income was booked or justified in each instance virtually without supporting detail and on the strength of inherently unacceptable explanations. Reasonable tests of EFCA's accounting records and other auditing procedures necessary in the circumstances should have exposed the impropriety of these and many other improper entries and thereby exposed the fraud.

After Seidman & Seidman combined practices with the Los Angeles office of Wolfson Weiner, the audits for EFCA and most of its subsidiaries in 1971 and 1972 were performed by that firm. But the change was in name only. After the combination of practices the same people were left in control of the EFCA audit and apparently no Seidman representative reviewed their performance. Hence, the imprimatur of Seidman & Seidman on EFCA's financial statements did not signify any notable change in underlying procedures. It is not surprising, therefore, that the 1971 and 1972 EFCA audits were also conducted incompetently.

The 1972 audit by Seidman was especially deficient because only on that occasion did a single accounting firm audit each aspect of the funding operation. As has been explained elsewhere in this report, the funding operation consisted of four basic activities: sale of programs, financing, purchase of mutual fund shares and issuance of insurance. These activities were conducted in three entities: EFC-Cal, EFSC and EFLIC. The various accounting aspects of the funding fraud at these three companies were not integrated with each other. A single bogus transaction could not be traced through the books and records of the respective entities involved, because no effort was made by the conspirators to develop mutually consistent documentary

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* See page 25.

** See pages 29-35.

† See pages 64-73.

†† See page 41.

support. Thus, for example, on the books of EFLIC, journal entries were made to record fictitious insurance premium income in an inter-company account as a receivable due from EFC-Cal, and bogus files were developed at EFLIC as needed to support this fictitious income. On EFC-Cal's books, however, no corresponding entries were made to show premiums payable to EFLIC.

Through 1971, Wolfson Weiner (later Seidman & Seidman) examined the books of EFC-Cal and EFSC, while Haskins & Sells examined the books of EFLIC. Numerous improper entries should have been discerned by a careful auditor from the books of EFC-Cal and EFSC alone. When in 1972 Seidman & Seidman audited EFLIC, as well as EFC-Cal and EFSC, the funding fraud ought to have been nearly self-revealing, because of the obvious inconsistencies between the books and records of the three companies. Evidently, however, the accountants from Seidman & Seidman who examined EFLIC's books did not coordinate their work with personnel who audited the parent and other subsidiaries (who were mostly former Wolfson Weiner accountants). In any event, the discrepancies were either not discovered or ignored.

B. **EFLIC's Auditors.**

From 1968 to 1971, EFLIC was audited by Haskins & Sells. The body of this report does not contain as much information about these audits as it does about those performed by Wolfson Weiner and Seidman & Seidman. This is primarily a function of the fact that EFLIC has been under the joint conservatorship of the Departments of Insurance of the States of California and Illinois, and not under the direct jurisdiction of the Trustee. Moreover, thus far the Trustee's counsel has not had the same access to testimony by Haskins & Sells' accountants or to work papers for audits conducted by that firm. Enough is known, however, to suggest that Haskins must share significant responsibility for the persistence of the fraud at Equity Funding.

It is by now obvious that the fraud was not merely an insurance scandal. However, the fact remains that a massive fraud was perpetrated on the books of EFLIC, the Company's primary insurance subsidiary. More than $2 billion in face amount of bogus policies were reinsured by EFLIC, and almost $30 million of fictitious premium

and other income was reported by that company. For a number of reasons it appears to the Trustee that Haskins & Sells should have detected sufficient evidence of this aspect of the fraud to have prompted its discovery.

For one thing, Haskins & Sells did not adequately check the procedures by which information was generated through EFLIC's data processing system. Very heavy reliance for information about EFLIC's operations was placed on print-outs and similar data produced by the Company's computers. Nevertheless, Haskins & Sells failed to review the internal controls of the computer installation. These controls were in fact weak or non-existent, a condition which made it possible for special print-outs which merged legitimate and bogus information to be prepared for the auditors.

In the Trustee's judgment, this failure was a serious omission. However, the most fundamental shortcoming in Haskins & Sells' performance was its nearly complete dependence upon information from internal EFLIC sources. It failed to obtain verification of this information either from the books and records of affiliated companies or from third parties.

Normally accountants auditing an insurance company have primary source records readily available from which to correlate reported data concerning premiums, insurance in-force and commissions paid. In a proper audit, tests are made to determine that all this information ties together and is internally consistent. Haskins & Sells did not have primary source records from which to perform such tests at EFLIC because records of both premiums earned and commissions paid to agents were kept by EFC-Cal, a separate entity. In these circumstances, EFLIC was not auditable apart from some reasonable verification of the premium and commission information furnished by its affiliate. Haskins & Sells should have tested EFC-Cal's records showing premium receipts, or the generation of premiums through funding, and commission payments to EFC-Cal salesmen. Had the auditors done so, they would have found glaring discrepancies which should have prompted discovery of the fraud.

Nor did Haskins & Sells confirm insurance in-force directly with purported policyholders. Such confirmations were called for in

EFLIC's case. Under principles of statutory accounting, policies are carried on the balance sheet of an underwriting company as a reserve liability. There would be limited, if any, reason for such a company to inflate the amount of in-force policies on its books since that would increase its liabilities. Under such circumstances, it might be argued there is no need to confirm the amount of insurance in-force.

However, where a company reinsures a substantial portion of its business, the situation is materially different. The ceding company generates income from such business, while the reinsurer assumes the reserve liability. Hence, even a statutory reporting company has an incentive to overstate the amount of its in-force insurance when it reinsures much of its business. Where such a company converts from statutory accounting to generally accepted accounting principles ("GAAP"), the incentive is all the greater. This is so because GAAP accounting results in the accrual of income from policies at the same time reserves are set up. EFLIC began large-scale reinsurance in 1969 and converted to GAAP accounting in 1971. Thus, for both these reasons Haskins & Sells should have confirmed the amount of insurance the company claimed to be in-force. Such confirmation was even more vital in EFLIC's case in view of the absence of any testing by the auditors of primary source documents for EFLIC's principal income and expense items.

III. A FINAL POSTSCRIPT

Literally hundreds of persons and firms had business relations with EFCA during the life of the fraud. To a varying degree, they all had some opportunity to observe the real workings of the Company. Others, including government regulators and investment analysts, had an ongoing professional interest in the Company's performance and presumably had regular occasion to review EFCA's financial statements. All these individuals and entities had at least a chance to spot clues of the scandal. Without intending to prejudge questions of legal duty, the Trustee does not find it surprising that no one did so.

Although it is now evident that there were some discrepancies in EFCA's financial statements over the years, only someone examining the statements thoroughly, regularly and with a critical eye would

have found them. And only someone with an exceedingly skeptical bent of mind would have then inferred massive fraud. Such an inference would have been hostile to the presumption of good faith and honest-dealing which customarily prevails in American business practice. To the Trustee, that presumption, though sometimes grievously abused, is probably indispensable to a vigorous and productive economy.

When the scandal broke, lawsuits were filed all over the country naming as defendants nearly every person and company or institution that appeared to have had any significant contact with EFCA or its subsidiaries. Most of these lawsuits were filed when few of the facts were known and are evidently premised upon the assumption that these parties either knew or should have known about the fraud. Based upon the available evidence, this reaction seems to the Trustee unjustified. It appears rather that the banks, underwriters, reinsurers and others named in many of these lawsuits probably could only have discovered the fraud at EFCA by blind luck.

The same probably can be said of most of EFCA's Board of Directors. During the better part of the fraud years, EFCA's outside directors included a Harvard professor, a senior partner of a New York investment banking firm, and two experienced business executives—all of whom appear to have played active roles as directors of the Company. Based upon present information, however, there is nothing to indicate that any of these outside directors knew about the fraud. And, of course, they clearly had nothing to do with its discovery. Whether these men should have discovered the fraud depends upon one's view of the role directors should or realistically can be expected to play in the affairs of a large, publicly held corporation engaged in complex business activity, as was EFCA.

To the Trustee it seems unrealistic to expect directors to exercise the detailed oversight necessary to discover frauds perpetrated by determined and unprincipled executives. First, outside directors normally cannot make the major time commitment which such oversight would require. They are active in other pursuits and, indeed, are retained as directors because of the experience and judgment gained by reason of their principal activities. Moreover, outside directors rarely have substantial experience with the business of the

company upon whose board they have been asked to sit, since active outsiders with such experience are often precluded from serving as directors by antitrust considerations or conflicts of interest. As a practical matter, even inside directors have scant opportunity to discover an accounting fraud conducted outside of their area of responsibility.

The principal effect of imposing a duty to discover such frauds would probably be to discourage membership on corporate boards. An observation on this question fifty years ago by Judge Learned Hand seems no less apt today:

> "It seems to me too much to say that he [the director] must read the circulars sent out to prospective purchasers and test them against the facts. That was a matter he might properly leave to the officers charged with that duty. He might assume that those who prepared them would not make them fraudulent. To hold otherwise is practically to charge him with detailed supervision of the business, which, consistently carried out, would have taken most of his time. If a director must go so far as that, there will be no directors."*

At a time when many corporations are seeking to diversify their boards of directors with members having a public interest orientation, it seems especially inappropriate to depart from the notion that directors, like investors and others, are entitled to presume that the top management of a public corporation is essentially honest and that its auditors competently perform their duties.

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* *Barnes v. Andrews*, 298 Fed. 614, 620 (S.D.N.Y. 1924).

THE WALL STREET JOURNAL,
Thursday, June 5, 1975 5

Unit Says Properly Used Auditing Rules Would Have Found Equity Funding Plan

By FREDERICK ANDREWS
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—Generally accepted auditing standards weren't to blame for the failure of outside auditors to detect and disclose the massive fraud at Equity Funding Corp. of America, a special committee of the accounting profession has concluded.

"Customary audit procedures properly applied" would have reasonably assured detection, the five-member investigative committee said in a report to the American Institute of Certified Public Accountants. Except for two tentative suggestions, "no changes are called for in the procedures commonly used by auditors," the committee concluded. Its 46-page report was mailed to institute members this week.

The accounting institute appointed the investigative committee two years ago following the disclosure that Equity Funding had concocted and sold to other companies $2 billion face value of phony life insurance. Financial and auditing circles were mystified that the scheme could have escaped discovery by Equity Funding's independent auditors. Also, early versions of the fraud stressed the use of computers, giving rise to fears that computer techniques had outstripped the audit profession's ability to cope with them.

The panel was assigned to consider whether the scandal disclosed defects in existing audit standards. The performance of individual auditors was beyond the committee's scope, though the difficulty of evaluating audit procedures without considering how well or poorly they were applied plagued the panel from the outset.

Endorsed Existing Doctrine

The committee's report also endorsed existing audit doctrine that sharply limits an auditor's responsibility for discovering fraud. In that view, an auditor should be alert for fraud, but isn't at fault for failing to detect it unless the failure results from failing to follow generally accepted practices.

The committee studiously refrained from considering whether Equity Funding's auditors were to blame. "It's a conclusion we tried hard not to put in. I guess you can draw your own conclusions," said Marvin L. Stone, the committee's chairman and senior partner of Stone, Gray & Co., a Denver accounting firm. The panel's assignment was to assess procedures, rather than people, Mr. Stone reiterated. "We tried hard to walk that narrow line," he added.

Last month, a federal jury in Los Angeles convicted three former auditors of Equity Funding on multiple counts of securities fraud and making false statements in filings with regulatory authorities. In addition, private lawsuits alleging hundreds of millions of dollars in damages are pending, with Seidman & Seidman and Haskins & Sells, two national accounting firms, prominent among the defendants. Both have denied any wrongdoing.

The Equity Funding inquiry has been ticklish for the accounting institute from the beginning. Previously, the accounting institute postponed acting or commenting on particular controversies until any litigating was resolved.

Unanimous Conclusions

The audit panel's conclusions were unanimous, but two members, J. T. Arenberg Jr. of Arthur Andersen & Co. and Robert C. Holsen of Ernst & Ernst, dissented from publishing the report with litigation pending. They called the step "an unwarranted and potentially dangerous precedent" and said it suggested the Equity Funding audits were "deficient" even though the panel didn't assess fault. (The other two panel members were A. E. MacKay of Main LaFrentz & Co. and Leo E. Burger of McGladrey, Hansen, Dunn & Co.)

The report was rendered last February. Mr. Stone said normal processing delayed publication until now, but he conceded the panel was loath to publish its report until the auditors' criminal trial was over.

For its version of the fraud scheme, the audit committee said it relied mainly on the previously published reports of the court-appointed trustee at Equity Funding, plus interviews with his staff and Touche Ross & Co., an audit firm the trustee retained. The panel also examined Equity Funding records. It didn't talk with the company's former auditors, the report said.

Equity Funding sold "programs" under which an investor bought both mutual-fund shares and life insurance, pledging the shares as collateral for a loan to pay the insurance premiums. Investors signed notes, which Equity Funding carried as "funded loans receivable."

Two Separate Phases

Like the Equity Funding trustee, the audit committee focused on two separate phases of the scheme: first, the exaggeration of earnings for almost a decade by inflating the funded loans receivable and, later, the concocting of phony insurance policies, which were sold to other insurance companies.

The audit committee's report includes an eight-page review of routine audit tests that, in the committee's view, should have detected various portions of the scheme. The audit committee found that though Equity Funding officials falsified general ledger accounts, "there was virtually no attempt to create supporting documentation." For instance, they didn't concoct detailed records to support the total collateral supposedly on hand. Audit tests would have detected these gaps, the audit panel concluded.

The committee also found that the fraud perpetrators weren't able to keep the records of various Equity Funding subsidiaries consistent. These inconsistencies were similarly vulnerable to audit tests, the report says.

As one possible change, the committee suggested that sometimes it might be necessary for an auditor to check with purported policyholders to make sure a policy really exists. This check hasn't been required because normally companies haven't any motive to inflate their liabilities, one result of exaggerating insurance in force. But Equity Funding showed that the ploy can also inflate earnings, the committee said.

The committee cited another possible blind spot in existing audit routines: certain substantial amounts Equity Funding listed as owed it by two foreign companies. Routine audit tests "might have been ineffective," the committee said, because the companies turned out to be shells secretly controlled by Equity Funding. The panel didn't recommend specific auditing changes, however, because audit authorities already have such "related-party" transactions under study.

The audit committee also concluded:

—Equity Funding's internal accounting and controls were so weak an auditor would have expanded routine audit tests, thus increasing chances of detecting the fraud.

—A knowledge of computer audit techniques wasn't essential. The fraud was simply "computer-assisted," the panel said. The main falsification of records was done by hand, though at times the computer faked supporting documents that otherwise would have required enormous clerical effort.

—No matter how much an auditor does, there is never "absolute assurance" he will detect fraud, even "massive" fraud.

"What is sought is a reasonable degree of assurance," the panel said, and that must rely on "professional judgment as to how far inquiry should go. . . . There is no ultimate stopping place; each new level of tests offers yet another choice between reliance or still a further test."

AICPA

White House Conference July 2, 1975

American Institute of
Certified Public Accountants

REGULATORY REFORM

Discussion Outline

Presented by John F. Utley, CPA

Chairman, Committee on Regulated Industries

WHITE HOUSE CONFERENCE

July 2, 1975

I. **Introduction**

A. AICPA interface with regulatory agencies responsible for major regulated industries

1. Federal regulatory agencies

2. State regulatory bodies.

II. **Principal problems of existing Federal and State regulatory agencies**

A. Action on requests for rate relief

1. The pervasive problem is regulatory delays which generate uncertainty in the minds of investors and frustrate the acquisition of capital at reasonable cost

a. Delays attributable to administrative law requirements

- Procedures essential to avoid such delays and reduce, to some extent, existing uncertainty

b. Need for more informed decision-making—a skills question at the Commission level when financial input is required.

c. Delays attributable to staffing; inadequate both quantitatively and qualitatively to expedite decision-making

- Need for expanded funding for Federal regulatory agencies

- Need for Federal funding of State regulatory staffs

d. Need for greater recognition of the crisis in cash flow for regulated businesses and the necessity to depart from traditional ratemaking procedures to deal with the problem

- Inclusion of construction-work-in-progress in rate base
- Adoption of Comprehensive Tax Normalization
- Adoption of automatic adjustment clauses
- Awards of higher rates of return on equity to compensate for higher current financial risks of regulated companies
- Use of forward looking or projected year as a basis for setting rates.

B. Need for more effective staff utilization by regulatory bodies

1. Use of outside skills for compliance and surveillance activities. Examples of current use:

a. Federal Power Commission

b. Rural Electrification Administration

2. Greater use of data processing techniques by regulatory bodies to achieve efficiencies in staff utilization

a. Annual and periodic report modification to accommodate such revisions

3. Need for amendments to Uniform System of Accounts to provide the base for such efficiencies.

C. Need for basic changes in accounting practices to achieve greater cash flow.

D. Need to review filing requirements for rate increases in order to avoid delays attendant to having to request additional information.

III. **Regulation Mechanism: should it be reformed?**

A. AICPA position on whether regulation of basic industries should be continued in its present form.

IV. **Tax policy and regulated businesses**

A. Need for basic changes in tax policy to alleviate serious capital problems of utilities generally, and electric utilities particularly.

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WALTER E. HANSON
SENIOR PARTNER

May 4, 1976

Senator Lee Metcalf
Committee on Government Operations
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

In order to obtain the material requested in your letter of April 8, it was necessary to circularize our partners concerning their testimony or presentations given to Congress, state legislatures, and Federal and state regulatory commissions, since January 1, 1975. As a result of that circularization, we are enclosing the following documentations:

1. Testimony of William G. Morrison, Jr. on behalf of United Parcel Service before the Postal Rate Commission.

2. Comments by Frank M. Burke, Jr. on proposed regulations on percentage depletion under The Tax Reduction Act of 1975 before representatives of the United States Treasury Department and the Internal Revenue Service.

3. Discussion outline presented by William Freitag, Chairman of the Task Force on Health Care Reform, for the White House Conference on July 2, 1975. We understand this presentation was presented by the AICPA to the Subcommittee on Health of the House Ways and Means Committee.

4. Statement of Hugh C. Braly before the House Ways and Means Committee on behalf of Rocky Mountain Oil & Gas Association.

Our partner, Anthony M. Mandolini, testified before the Illinois Intergovernmental Cooperation Commission concerning the enactment of new legislation in the State of Illinois to implement a requirement of the new state constitution that the legislature shall prescribe systems of accounting, auditing, and financial reporting for units of local government including school districts. We do not have a copy of that testimony, but understand it can be made available through the State of Illinois. Mr. Mandolini testified as chairman of the Steering Committee of the Advisory Committee on Local Government Accounting, Auditing and Reporting Practices of the Illinois Society of CPAs.

To the best of my knowledge, these would be the only items from PMM&Co. that would fall within the scope of your request. I am sorry that we were unable to meet the required deadline, but as indicated, this information was not centrally available and required a circularization of our individual partners.

Sincerely yours,

WEH:ebs

Enclosures

(Staff note: The other enclosures from Peat, Marwick & Mitchell are retained in the committee files.)

(Excerpt from House Ways and Means Committee hearings on Tax Reform 1975, July 22, 1975.)

STATEMENT OF HUGH C. BRALY, ROCKY MOUNTAIN OIL & GAS ASSOCIATION

Mr. BRALY. My name is Hugh Braly. I am a partner in Peat, Marwick, Mitchell & Co. I appear before you today as a representative of the Rocky Mountain Oil and & Gas Association.

We wish to urge the committee to not change the intangible drilling deduction rules. We urge the committee not to impose additional taxes upon the sale of oil and gas properties by reason of the proposal to treat certain parts of the income that might result as ordinary income under the recapture rules that have been applied in other areas of the Internal Revenue Code.

With regard to the intangible drilling and development expense deduction, this has been a part of our tax system for many years and is well understood in both the oil and gas industry and by investors generally. It is an important part of the decision of any investor as to whether or not he is going to commit money to the search for oil and gas as to the amount of tax that might be saved or deferred by the deduction of such costs.

The proposed limitation of deductions of this kind of expense to the amount of income that the taxpayer has from mineral properties would discourage new investors particularly, and I think this is a very important point that the committee needs to keep in mind. The need for capital is such that within the industry I don't think it is possible to raise the needed funds.

Another point to keep in mind is the fact that while the deduction is allowed in full for dry holes, it may be limited in the case of a producing well. At the point a well becomes ready for completion, a large amount of additional capital is required for equipment for completion or perhaps the development of the field that may have been discovered. To deny deductions at that point would simply require the taxpayer to pay more taxes as well as paying for the additional capital requirements that would be imposed.

With respect to the proposal that ordinary income be realized on the sale of a property if there have been intangible drilling deductions previously taken, it seems to me that this proposal, while it has been imposed in the case of depreciable property, the reasoning at that time was it was simply a recovery of excess deductions that had been taken for the equipment's depreciation.

Here we do not have a property that has a separate value when you drill a hole in the ground. It cannot be valued, its relation to the reserves that are found is not direct at all. One well may be completely dry and another with equal cost may discover substantial reserves.

The change in treatment that might be imposed by reason of the deductions in future years does violence to the idea that each taxpayer should be treated equally on similar income. When he sells a property he should have a known tax based on income realized rather than on something that happened in prior years.

It also would cause potentially very large distortions or additional amounts of tax in the case of individual taxpayers because of the high rates that may be implied in years when he has high income.

For these reasons we oppose both any limitation on deduction of intangible drilling costs and the proposal to impose higher tax rates on the sale of oil properties where the intangibles have been deducted.

Thank you.

Mr. LANDRUM. Thank you.

[The prepared statement follows:]

STATEMENT OF HUGH C. BRALY REPRESENTING ROCKY MOUNTAIN OIL & GAS ASSOCIATION

PROPOSALS FOR CHANGES IN THE TAX TREATMENT OF OIL AND GAS

Summary

I. Members of the Rocky Mountain Oil & Gas Association oppose the proposed limitation on the deduction of intangible drilling costs for productive wells to the amount of aggregate taxable income of the taxpayer from mineral properties located within the United States.

(a) This would discourage investments in oil and gas exploration by taxpayers who did not already have income from mineral properties.

(b) To deny deductions of intangible drilling costs on productive wells will result in increased income taxes at a time when needs for capital to complete the well for production are at a maximum.

II. Recapture of previously deducted intangible drilling costs as ordinary income where the property is subsequently sold at a gain is opposed.

(a) An oil well has no value separate and apart from the underlying reserves.

(b) Intangible drilling costs incurred in drilling an oil well have no relationship to the value of the underlying reserves.

(c) To classify gain on sale of property as ordinary income based upon prior intangible drilling costs could only result on arbitrary, and often substantially different tax burdens for owners of otherwise similar property.

I. Limitation on Deduction of Intangible Drilling Costs

The United States is facing a critical shortage of energy derived from oil and gas, and it is extremely important that everything possible be done to encourage the oil and gas industry to maximize its efforts toward finding and developing new reserves. In order to do this, very large amounts of new capital must be invested. It is clear that a substantial part of such capital must come from sources outside of the industry because of the magnitude of the investment needs. For example, according to Chase Manhattan Bank's estimates, 770 billion dollars will need to have been invested by 1985.

At the same time, the nature of the search for new reserves is such that most of the usual sources for new capital are not available because of the extreme risk of failure that is involved.

The search for oil or gas reserves has always been risky. Such risk is steadily increasing since the remaining undiscovered deposits are reduced with each new discovery. Generally, the remaining deposits are deeper, or are located offshore, and consequently the search involves rapidly increasing costs and more potential drilling and completion problems than shallow wells. For these reasons, it will be rare indeed for an oil exploration company to raise funds from banks, insurance companies, pension funds, etc. for use in any exploration program.

In the past, a considerable portion of the new money that has been used in the exploration for oil and gas has come from individuals and other non-industry investors who have high taxable income. An important factor in their decision to invest in an exploration program has been that a considerable part of the money spent is immediately deductible for income tax purposes. The importance of income tax deductions or credits as an investment incentive is recognized in various places in our tax laws, and has been discussed in connection with provisions allowing accelerated depreciation of machinery and equipment, accelerated deduction for the cost of pollution control facilities, and the investment tax credit on equipment acquisitions.

The allowance of a current deduction for intangible drilling and development costs has been a part of our income tax system for many years. To change such rules at this time would disrupt long established and functioning relationships that are understood and attract needed capital. The proposal to change this rule is not based on any change in the concept that such costs are deductible in determining taxable income. The only change that is being proposed is a change in the timing of the deduction over a period of years. Such change would not appear to materially affect the total amount of income taxes that would be payable by such investors. The only change would be that they would pay more tax in the year that the expenditure was made, and less tax in future years.

For established oil companies, the proposed change may not limit their deductions for intangible drilling costs because they can plan their exploration budgets on the basis of projections of income and cash flow being derived from oil and gas operations.

The principal effect of the proposed change would be to limit the deductions available to new investors, and thereby make it less attractive to invest in an exploration program. The proposed limitation of a deduction for intangible drilling and development costs to the amount of income derived from related sources would discourage expansion of the search for new reserves of oil and gas.

Another factor to consider is that under the proposed change, a current deduction will be allowable for all of the costs of wells which are dry holes. If a producing well results, it will be necessary to invest substantial sums for equipment and the additional intangible costs involved in completing a producing well. To deny a current deduction for any of the costs of a successful well unless the investor has income from other mineral properties will mean that his cash requirements must all be met out of after-tax income.

In some cases, it may be possible to borrow a part of the money needed for this purpose, but generally loans cannot be obtained based upon the value of oil and gas properties until they have been producing for a long enough period to permit an evaluation based upon actual performance. It is not uncommon for oil companies to have severe financial problems, if their exploration program is successful, because of the very large capital requirements that are thereby generated. To impose higher income taxes at such a time can only result in reducing the amount of capital available for use in the exploration and development program.

II. Recapture of Intangible Drilling Costs

The Committee on Ways & Means has indicated an interest in a discussion of the recapture of intangible drilling costs deducted as ordinary income where the property is subsequently sold at a gain. On the surface, it would seem logical that ordinary income should be realized in cases where previously deducted expenses are recovered by the taxpayer through sale of the property, so that the benefit of taxing such recovery as a long-term capital gain would not result. However, the results of such a policy would be arbitrary and unpredictable because of the many factors that may be involved in each sale of oil and gas property.

For one thing, there is no way of selling separately, or even valuing the part of a property that results from previously deducted exploration and development costs. The amount realized from the sale of oil and gas reserves is based primarily upon the value of such reserves, not the well produced by the intangible drilling expenditure. To provide that income from the sale of oil and gas properties will be ordinary income to the extent of the intangible drilling costs that had been deducted previously would result in very arbitrary, and often unfair, results. It is not uncommon to find that the costs of wells that are of similar depths may vary greatly, and such costs have no relationship to the value of the reserves that such well can produce.

Another factor to consider, particularly in the case of the individual investor, is the steeply progressive tax rates applicable to high taxable income. To require that some part of the taxable income realized from the sale of an oil and gas property be treated as ordinary income would often result in a 70% tax rate being applied to that part of the income. Thus the tax imposed would have no necessary relationship to the total taxable income realized from the sale. It might well be increased because of bad luck which resulted in higher drilling costs in prior years, or decreased if drilling costs had been low in prior years.

It seems to me that to base the tax treatment of gains in the year of sale on prior year events does violence to the concept that an accounting is required of taxpayers on a year by year basis, and that taxpayers having similar income in a year should be taxed on the same basis. Accordingly, recapture of intangible drilling costs as ordinary income would not be proper.

¶ 3182 **RELEASE No. 173, July 2, 1975. In the matter of Peat, Marwick, Mitchell & Co.**

Opinion and order in a proceeding pursuant to Rule 2(e) of the Commission's Rules of Practice.

Between February 1972 and March 1974 the Commission filed four civil injunctive complaints against Peat, Marwick, Mitchell & Co. ("PMM") relating to PMM's examinations of financial statements of National Student Marketing Corporation ("NSMC"), Talley Industries, Inc. (Talley"), Penn Central Company ("Penn Central"), and Republic National Life Insurance Company "Republic National"). In addition, the Commission has completed an investigation relating to Stirling Homex Corporation ("Stirling Homex") which has also raised questions concerning PMM's audit of this Company's financial statements.[1] In order to resolve these controversies, PMM has submitted an offer of settlement which is described in detail below, and which we have considered and determined to accept. As contemplated by the settlement offer, without admitting or denying any of the statements and conclusions set forth herein, PMM has agreed to the institution of this Rule 2(e) proceeding and the issuance of the order hereinafter set forth.[2]

The facts of these five matters, as they appear to the Commission, are set forth in some detail below, together with the Commission's views on the accounting and auditing lessons to be learned from them. The following highlights certain of the basic problems which have been noted by the Commission in these matters:

The first set of problems relate to the process of taking on a new audit engagement and planning for the first audit. Three of these cases involved initial audits.

In the *NSMC* case, there was inadequate communication between the predecessor auditor and PMM which resulted in PMM's being unaware of doubts which the predecessor auditor had as to the integrity of management. In the *Republic* case, PMM was aware of disagreements between their predecessors and Republic's management regarding disclosure of and accounting for investments in its major debtor, but PMM did not investigate these differences in sufficient depth. The Commission, in *Accounting Series Release No. 153*, already has expressed its view that the basic responsibilities of auditors require full communication between predecessors and successors. Another lesson appears in *NSMC* and *Stirling*, where the auditors accepted assertions by management concerning the special circumstances of the business involved although presentation of the supposed results presented unusual accounting and auditing problems. In considerable measure this occurred because the auditors were not sufficiently familiar with the business context to as-

[1] The first four matters have been the subject of injunctive actions brought by the Commission against the companies involved, other persons and PMM. *SEC v. National Student Marketing Corp. et al.*, Civil Action No. 225-72 (D.D.C.); *SEC v. Peat, Marwick, Mitchell & Co., instituted sub nom; SEC v. Talley Industries, Inc., et al.*, 73 Civ. 4603 (S.D.N.Y.); *SEC v. Republic National Life Insurance Co., et al.*, 74 Civ. 1097 (S.D.N.Y.); *SEC v. Penn Central Co. et al.*, 74 Civ. 1125 (E.D. Pa.). The fifth matter has been the subject of an investigation of the company, other persons and PMM. This opinion, except incidentally, does not attempt to deal with the other persons involved in these various controversies.

[2] For purposes of this settlement and carrying out of any procedures contemplated herein, PMM has waived separation of functions between the staff and the Commission.

sess the representations of management. Auditors should be particularly careful when the client asserts that special circumstances require unusual accounting or auditing solutions and should either possess or avail themselves of sufficient industry knowledge to judge the substance of the situation. In addition, in *Stirling* there was a division of ultimate authority for the engagement between two partners, one of whom operated out of an office far removed from the executive offices and the manufacturing facilities of Stirling, so that his ability to activly plan and supervise this difficult first audit was substantially reduced.

Another problem area highlighted by several of the cases is the need for emphasizing the importance of substance over form in determining accounting principles to be applied to particular transactions and situations. In addition to considering substance over form in particular transactions, it is important that the overall impression created by the financial statements be consistent with the business realities of the company's financial position and operations.

In the *Penn Central* case, PMM did not place sufficient emphasis on the economic substance of several transactions and hence permitted these transactions to be accounted for under principles which in our view were not applicable in the circumstances. More importantly, the inclusion of the sum of all these transactions in financial statements resulted in statements which, taken as a whole, did not communicate to the user the business realities of the company's financial position and operations.

We believe that an auditor must stand back from his resolution of particular accounting issues and assess the aggregate impact of the particular issues upon a reasonable investor's perception of the economic substance of the enterprise for which financial statements are being presented.

In several of these cases, serious problems arose in the application of percentage of completion accounting and its improper use to accelerate the recognition of revenue. Percentage of completion accounting is normally used in situations where the conventional approach of recognizing revenue at the point of sale and delivery would produce a misleading picture of business activity. This is normally the case where there are substantial projects lasting longer than a year, where ultimate sales are assured by contract and where reasonable estimates can be made of the cost to complete the project. In the *NSMC* case, no firm sales had been made and, in fact, the percentage of completion was measured by the estimated percentage of sales effort expended. In addition, "projects" were of short duration and cost estimates were uncertain. Similarly, in *Stirling,* sales contracts were dependent on obtaining financing which was highly uncertain, and the costs of completion were difficult to estimate.

These cases emphasize that the use of accounting principles must be evaluated in the light of their applicability to the facts of the particular case, and that professionals must exercise the greatest care and judgment in appraising their applicability. While management may initially select the principles to be followed, the independent accountant must be satisfied that in his professional judgment the principles selected are those which appropriately describe the business reality within the general framework of the accounting approach to economic measurement.

Finally, in most of these situations, the auditors accepted the representations of management without obtaining independent audit verification of the realities underlying transactions. While the Commission does not suggest that management representations are not a significant source of evidence, it is apparent that if the independent professionalism inherent in the auditor's role is to be maintained, evidence beyond these assertions must be obtained in significant audit areas.

In *Talley,* for instance, the auditors accepted management's estimates of contracts to be received despite the fact that Talley had to predict both total government contracts to be awarded and the company's expectations of its share of such total contracts. These largely subjective judgments were based on various forms of "soft" data and were not sufficient for the purpose of assuming future orders. They also accepted Talley's estimates of per unit cost reductions despite the fact that Talley's cost system was not capable of (and did not attempt to) monitor differences between estimated and actual cost figures.

The recognizing of revenue in the *NSMC* case depended in part on the firmness of the "contracts" with NSMC's customers. In that regard the auditors relied heavily on management's representations that oral contracts were not unusual and were suf-

ficiently firm to be a basis for recognizing revenue. In the initial audit, they did not insist on written confirmations from customers.

In *Stirling* sales and income were recognized in connection with the manufacturing and installation of modular housing for local housing agencies although the agencies, themselves without funds, were dependent upon federal financing and binding commitments for such financing were absent. In the Commission's judgment, PMM accepted representations that documentation from the local agency constituted or was the practical equivalent of committed federal financing. Assignments of modules to specific contracts, ability to recover installation cost overuns and the status of particular projects were other areas where PMM largely relied upon management representations and did not perform appropriate audit steps.

* * * * *

The following is a description of the five cases.

NATIONAL STUDENT MARKETING CORPORATION

Prior to discussing PMM's role as independent auditors for National Student Marketing Corporation ("NSMC") reference should be made to the circumstances under which the firm was engaged. In April 1968, NSMC made a registered public offering of 30,000 shares of its common stock.[3] At the time of this registered stock offering, NSMC's independent auditors were Arthur Andersen & Co. and Covington & Burling was its outside counsel. In July of 1968, shortly before the close of NSMC's fiscal year, Covington & Burling resigned as counsel to NSMC and was succeeded by White & Case "NSMC's outside counsel"). At approximately the same time, Arthur Andersen advised NSMC that it would not be available to undertake audit responsibilities for the fiscal year ending August 31, 1968. Arthur Andersen's decision to resign apparently came as a result of a series of events which led Arthur Andersen and Covington & Burling to question the reliability of information which they received from NSMC's management.

Upon being requested by NSMC to accept the audit engagement, PMM's Washington office inquired of the managing partner of the local Arthur Andersen office as to whether there was any professional reason why PMM should not undertake to act as outside auditors for the company. This limited inquiry, which the Commission believes should have been viewed as including questions regarding management integrity, was answered in writing in the negative. PMM did not ask for the reasons why Arthur Andersen had resigned and Andersen did not supply any information in this regard.[4] The Commission belives that information pertaining to the integrity of management should be communicated between predecessor and successor auditors. The resulting failure of communication caused PMM to undertake this engagement at a distinct disadvantage. While the kind of information Arthur Andersen and Covington & Burling had did not necessarily go to the fundamental integrity of NSMC's management, it was nevertheless significant information which PMM should have sought more aggressively. The significance of the simultaneous changes of the independent auditors and outside counsel also should not have been overlooked. This additional information might have added significantly to the normal "healthy skepticism" with which the auditor approaches a professional engagement.

PMM's August 31, 1968 Engagement — Accounting for Fixed Fee Programs

NSMC was organized in 1966 to engage in the development, marketing and implementation of various products and services of its own and of its clients to high school and college students. At this time, it maintained its executive offices in Washington, D. C.

The clients of NSMC were companies wishing to sell their products and services in the student market. NSMC designed youth-oriented advertising programs to fit the needs of individual clients and sold its ability to implement those programs by distributing various materials directly to the so-called youth market. Media used by NSMC in its youth marketing activities included campus poster advertising, handouts, direct mail, desk pads, college directories, newspaper insertions, films and product sampling. NSMC sold its services

[3] NSMC's common stock was offered to the public at $6.00 per share. By September of 1968, the stock was selling at $70 per share, about 350 times the last reported audited earnings per share.

[4] Arthur Andersen acted on advice of counsel. We believe that at a minimum the fact that their response was limited by such advice should have been communicated.

through account executives whose duties encompassed solicitation of prospective clients, explanation of NSMC's marketing capabilities and development and design of specific programs to meet clients' marketing objectives. Posters, handouts, samples and other promotional materials used in the marketing programs were often made and delivered to the NSMC distribution network by outside vendors and/or by the clients themselves. NSMC's distribution network consisted of part-time campus representatives employed by NSMC who worked on a commission basis.

NSMC's revenues were generated on either a commission or fixed fee basis, depending upon the nature of the program. An example of a commission program was the distribution of posters with tear-off coupons for a magazine subscription. The client would pay a fee to NSMC per subscription application coupon received. An example of a fixed fee type program was a direct mailing to a specific number of addresses for a flat fee. Fixed fee business first became significant for NSMC during the latter half of fiscal 1968.

As described to the auditors, NSMC's increased efforts to obtain clients for particular marketing programs on a fixed fee basis were centered on NSMC's recently expanded national sales operation centered in New York City. The company had hired several account executives whose efforts involved the creation of an overall marketing program—marketing strategy, media selection, art work, and the like—tailored to the needs of a particular client, its presentation to the client, possible revisions and a new presentation, and ultimately acceptance by the client. The programs were directed to the student market and thus were to be implemented at various seasons during the academic year. The program effort was the responsibility of the particular NSMC account executive who drew upon and supervised the various necessary talents of the New York office staff. As represented by NSMC's management, the only remaining functions after acceptance by the client were those of an essentially mechanical nature such as printing, mailing placing posters, and the like, with their costs being susceptible to a reliable estimation. A substantial amount of firm commitments allegedly had been obtained for such fixed fee programs prior to August 31, 1968, and it was represented that the creative effort had thus been largely accomplished, although implementation of the programs and billings were to take place at a later date. It was explained by NSMC to the auditors that, as was a common practice in the industry, these commitments were for the most part not in written contract form.

When PMM commenced its examination of NSMC's financial statements for the fiscal year ended August 31, 1968, it became immediately clear that NSMC's internal accounting books and records were in very poor condition and that the journal entries were a month or two behind. By early October a preliminary profit and loss statement had been prepared by management which reflected a loss of approximately $220,000 for that year. It was at this time that the company's management, principally its chief executive officer, advised the auditors that its books and records did not include substantial amounts of revenues generated by NSMC's New York office through the sale of fixed fee programs. From the beginning of October to the middle of November, additional information was supplied to the auditors by NSMC which purported to show substantial commitments which would result in income arising out of the operations of this aspect of NSMC's business. Approximately 96% of NSMC's consolidated earnings before income taxes and extraordinary items and forty percent of its assets resulted from the inclusion of NSMC's financial statements for 1968 of revenues, less the accrual of related costs, from these fixed fee programs described in the financial statements as "contracts in progress." In our view, both this accounting treatment and the auditing in respect thereof were inappropriate for several reasons. Of the $1.76 million in revenues from unbilled receivables appearing in NSMC's 1968 financial statements, only about $200,000 was covered by written contracts from NSMC's clients.[5] The rest was reported as "contracts in progress" but in fact consisted of what were said to be oral "commitments," the sole written evidence of whose existence consisted in most part of one page commitment reports of the NSMC account executives. All of these commitment reports from the account executives were dated in October, some six weeks after

[5] It was NSMC's practice not to enforce even written contracts if the client never ordered implementation. In fact, the written contracts which they did have in 1968 covering fixed fee programs included guarantees that a certain level of market performance would be achieved.

the close of the company's fiscal year. These reports gave no indication that the purported commitments existed on August 31, 1968. The auditors' work papers do not reflect that efforts were made to test whether they existed at August 31, 1968 or not.[6]

Revenue should be recorded on a percentage of completion basis only in circumstances where (1) the ultimate realization of the revenue is reasonably assured, (2) the completion of the contract requires a relatively long period of time, (3) the partial performance of the contract is a reasonable measure of business activity and (4) the cost of completion can be reasonably estimated. In our view, none of these criteria was met with respect to the accounting for fixed fee programs, and the application of the percentage of completion accounting method to these circumstances was inappropriate. In addition, the determination of percentage of completion on the basis of what, in our view, was only sales effort appears to us to be totally inconsistent with the basic principles underlying revenue recognition. Furthermore, the method used ignored all cost of implementing the program in computing the percentage of completion, although such costs were accrued. Moreover, the company relied only on its account executives for their estimates of the percentage of completion. Although the auditors claim to have tested these representations and estimates by the account executives, they did not document such testing in their work papers.[7]

The accounting method utilized for the fixed fee programs made no allowance for, and the financial statements made no reference to, guarantee provisions in a substantial number of the program by which, in the event the response level did not reach a stated minimum, NSMC was obligated either to accept a reduced fee or to rerun the program at no cost to the client. Since NSMC had had no significant past experience with the fixed fee programs, its liability to make good on these guarantees could not accurately be estimated.

By way of summary, some measure of the inappropriateness of the percentage of completion accounting applied to the fixed fee programs in the company's 1968 financial statements may be gleaned from the fact that during its 1969 fiscal year the company wrote off over 75% of the $1.76 million in revenues ascribed to the fixed fee progarms previously reported in the 1968 statements.[8]

In addition to the propriety of the accounting method is the question of appropriate auditing procedures with respect to fixed fee programs. Standard of Field Work No. 2 of Generally Accepted Auditing Standards requires the auditor to make "a proper study and evaluation of the existing internal control [of his client] as a basis for reliance thereon." The 1968 audit was PMM's first audit of NSMC. PMM's work papers contain evidence that the audit was the beginning of adequate record keeping for the fixed fee programs.[9] In this respect, the workpapers themselves were the principal records from which the financial statements were prepared. In light of the fact that the auditors did not consider NSMC to have a reliable system of record keeping, nor an adequate system of internal control, and that NSMC had no substantial prior experience with fixed fee commitments, the extent of the auditors' reliance on information supplied by NSMC, we believe, was improper. For example, they accepted the percentages supplied by NSMC's account executives of the amount of work that had ostensibly been completed on any particular commitment, even though, to their knowledge, NSMC had no written instructions concrning how this was to be computed.[10] As noted earlier, although the auditors claimed to have examined the ac-

[6] See § 338.02 of Statement on Auditing Standards No. 1 (AICPA) on the form, content and nature of working papers.

[7] It is worth noting in this connection that at least one account executive testified that he believed that this percentage of completion represented NSMC's likelihood of getting the commitment from the client.

[8] As discussed below, no disclosure of these write-offs was made in subsequent financial statements until after the Commission began its investigation into NSMC's affairs.

[9] PMM's audit supervisor reported that NSMC's "accounting, bookkeeping and maintenance of files were almost forgotten . . . . The net result is that our working papers represent the beginning of proper record keeping and accounting procedures for recording gross income on contracts."

[10] PMM's management letter to NSMC of January 2, 1969 urged that these procedures be strengthened considerably:

"Due to the nature of the activity of the company, sales are recorded when a client commitment is considered to exist. The amount of the sale recorded is based on the percentage of time incurred to the estimated time to be incurred by the employees in developing overall programs for the client. Because the time of these employees is extremely important in developing a systematic method of recording sales, it is imperative that the company adopt a policy whereby

(Continued on next page.)

count executive's files to verify and test the percentage of completion figures utilized. such examination was not documented in the audit workpapers.

Moreover, the auditors did not obtain written confirmation from any of NSMC's clients. Company officers informed them that its clients, not having been asked to formalize in writing their acceptance of NSMC's programs in the first instance, did not expect to be called upon to do so at a later date and might well back off from doing busines with NSMC if asked to do so. As a result PMM did not send written confirmations. The auditors concluded that the existence of these commitments could be determined by telephone confirmation of a representative selection of the oral commitments and review of such written commitments as existed.[11] A number of the telephone calls were placed by NSMC's account executives and the auditors did not insist on proper audit controls for these oral confirmations. Although there may be very limited situations where telephonic confirmations can properly be utilized as an auditing technique, provided adequate controls are maintained,[12] in our view such a procedure was inappropriate for NSMC.[13]

NSMC's Proxy Statement

During the period from November 1968 to May 1969, NSMC acquired additional companies primarily through the issuance of its common shares. In the Spring of 1969, PMM was engaged to assist the company in consolidating unaudited figures as at February 28, 1969 to be used in a proxy statement to obtain authorization from its shareholders for the issuance of additional shares needed for its acquisition program.

Retroactive Adjustments. At about this time, the auditors were informed that an account executive of the company had been terminated for alleged unethical conduct and that a subsequent review of the accounts which this individual supervised disclosed that four particular client commitments for fixed fee programs which he had earlier reported had never in fact existed. These commitments involved gross sales of approximately $750,000 which amounted to approximately 43% of the fixed fee sales reported in the company's previously issued financial statements for the fiscal year ended August 31, 1968. Costs of some $540,000 had been accrued on these commitments, resulting in a net reduction on the company's income before taxes for the prior period of some $210,000. The auditors suggested that this income should be written off retroactive to August 31, 1968, and the company adopted this procedure.

About the same time that this retroactive write-off was being discussed with the company, PMM's tax department, which had been engaged in the preparation of the company's tax return, indicated that they believed that the provision for deferred taxes which appeared in NSMC's 1968 financial statements appeared to be in error as a result of certain net operating loss carry-forwards which the company was reporting on its tax returns. After being apprised of this, members of PMM's audit staff eliminated a portion of the 1968 provision for deferred taxes in the amount of approximately $190,000, and a retroactive adjustment to this effect was made on the company's books as of August 31, 1968.[14]

(Footnote 10 continued.)

these employees report their time to the accounting department on a weekly or other timely basis, report in writing commitments obtained from clients, and estimates of time to complete committed contracts. In addition, preprinted forms should be used to obtain written confirmation of all client commitments.

"Working with Mr. Kurek and Mr. Davies, we have recently designed appropriate forms for use in the above connection. We urge that implementation of the recently established program be followed up very closely and that no wavering from the rejuired procedures be permitted."

[11] For the fiscal year ended August 31, 1969, at the auditors' insistence NSMC recognized revenue only on fixed fee programs which were evidenced by a written letter of commitment by the client. These commitments were confirmed in writing by the auditors. Again the Commission believes that such commitments, even when confirmed in writing, should not have resulted in recognized income resulting from the application of the percentage of completion method, for the reasons previously specified for the year ended August 31, 1968. Following the institution of the Commission's investigation, the company adopted the completed contract method for the fiscal period ended December 31, 1969.

[12] See, *e.g.*, AICPA Industry Audit Guide, Finance Companies, p. 105, 1973.

[13] See Section 331.01 of *Statement No. 1 on Auditing Standards* "Confirmation of receivables and observation of inventories are generally accepted auditing procedures. The independent auditor who issues an opinion when he has not employed them must bear in mind that he has the burden of justifying the opinion expressed." The auditors did not satisfy this burden because no adequate documentation existed.

[14] PMM later determined that this adjustment was in error.

Work on the proposed proxy statement was suspended to facilitate shareholder approval of several additional mergers that were then contemplated. When preparation of the proxy statement was renewed, PMM personnel considered the question of whether the retroactive adjustments to the 1968 audited statements should be disclosed in a footnote to the consolidated statement of earnings set forth in the proxy statement which was to reconcile the originally reported net sales and net earnings with the restated amounts resulting from pooled companies reflected retroactively.

The auditors took the position that the write-off of the previously erroneously reported client commitments and the extraordinary item which was a correction of the tax provision error, both retroactively applied to 1968, approximately cancelled each other out in their effect upon previously reported 1968 net income. The difference, amounting to approximately $21,000, was an amount deemed by the auditors to be immaterial. They felt that the size and character of NSMC had changed substantially through acquisitions since PMM's report on the previous year's audited statements had been released. While the August 1968 financial statements originally reported sales of $4.9 million and net income of $388,000, the proxy statement reflected sales for that year of $11.5 million and net income of $773,000, after giving effect to pooled companies reflected retroactively, as well as the retroactive contract and tax adjustments.

It is the Commission's view that what the auditors did had the effect of improperly netting extraordinary and ordinary items of income and that in any event, disclosure of both of these adjustments was required by paragraph 26 of *Opinion No. 9* of the Accounting Principles Board. None of these adjustments, moreover were, disclosed anywhere in the proxy statement filed with the Commission and disseminated to stockholders; rather, they were improperly subtracted from the amounts shown for sales and earnings of pooled companies acquired by NSMC after August 31, 1968 in the reconciliation footnote.

About the same time that they were informed of the four alleged nonexistent client commitments, the auditors were also informed that the company was writing off against the current year's operating income certain other fixed fee programs which had been included in the 1968 statements but were not being implemented for various reasons. Despite this adverse experience, the auditors took no steps to re-examine or otherwise take a fresh look at its 1968 audit or the procedures and principles utilized therein with respect to fixed fee programs, even though NSMC was utilizing the 1968 audited statements, which were being represented by NSMC to be true and correct, to acquire other companies.[15]

The Commission believes that these judgments were erroneous. The auditors were aware that the company was experiencing current difficulty with the implementation and realization of income from the fixed fee programs. Payments were not being received from these commitments in the ordinary course. Several of the commitments for which income was attributed in fiscal 1968 were being written off currently and the ultimate collectibility of a substantial number of other 1968 programs still on the company's books was, at this time, subject to serious question.

It is the Commission's view that disclosure of these very substantial write-offs was essential under the circumstances. The write-offs affected what was represented by NSMC to be its basic and unique line of business. The write-offs exposed the weakness of that part of the company's operations which was at the heart of its entire acquisition program.

The Nine Month Statements

The unaudited nine-month earnings statement included in the proxy statement was compiled by NSMC with PMM's assistance, using the same percentage of completion accounting theory as in the 1968 figures. However, by the time the proxy statement was issued, PMM knew not only that a material amount of the 1968 commitments never existed, but that throughout fiscal 1969 the company was writing off in current periods other commitments that had been recorded in the 1968 figures that were not implemented for one reason or another.

[15] Following the institution of the above injunctive action against PMM and others, the Commission referred the actions of PMM's engagement partner and audit supervisor to the Department of Justice. On January 17, 1974 an Indictment was returned charging them with making and causing to be made false and misleading statements with respect to material facts in the NSMC proxy statement referred to herein. Judgments of conviction were entered against them on December 27, 1974. Those convictions are presently on appeal. *United States v. Natelli*, Docket No. 75-10004.

In compiling the nine-month financial statements for the period which ended May 31, 1969, in at least one instance the Firm refused to permit the inclusion of income from commitments where there was no evidence of a writing signed by the client. PMM determined to eliminate from the nine-month earnings statement a purported commitment from the Pontiac Division of General Motors Corporation in an amount of over $1 million because PMM was not satisfied with the written evidence supporting such commitment. However, NSMC substituted a commitment in a lesser amount from Eastern Airlines. This letter from the client supporting this commitment was produced in August 1969 at the printers by an NSMC official for the first time while preparation of the proxy statement was in process.

The appearance of this commitment letter followed what had been, in our view, a suspicious pattern of post-period discovery of income items by NSMC management. In October 1968, as noted above, following a trial balance which showed a loss, $1.7 million of client commitments was disclosed to PMM for inclusion in the revenues for the period ending August 31, 1968. Although a substantial portion of these commitments was written off the company's books during the six-month period ending February 28, 1969, these write-offs were replaced with the so-called Pontiac commitment in the amount of $1.2 million, which represented another material addition to NSMC earnings two months after the fiscal period had ended. Yet, despite this experience, PMM did not object to the recording of the Eastern commitment. While the Commission recognizes that PMM was engaged in a proxy review rather than an audit of the nine month financial statements, nonetheless, we believe that under all these circumstances then known to PMM, the auditors should not have concurred in the decision to recognize income arising out of this commitment and should not have continued to be associated with the financial statements.

At the time the proxy statement was filed, NSMC and the auditors knew that of the $3,347,775 of unbilled accounts receivable recorded in the 18-month period ended February 28, 1969, some $2,055,523 (61%) had been written off,[16] an additional $310,972 (9%) was uncollectible or was to be written off and some $123,006 (4%) was inactive and the balance, some $858,274 (26%) had been billed or billed in part. None of these write-offs was separately disclosed. Despite the fact that the company had ostensibly changed its procedures for booking these commitments and that the size and character of the company had changed through acquisitions, fixed fee commitments still accounted for a significant portion of the company's business. Although this method of accounting had proven to be completely unreliable, revenues continued to be accrued in much the same fashion through August 31, 1969.

PMM's Comfort Letter

The approval of the shareholders was solicited on the basis of NSMC's August 31, 1968 and May 31, 1969 financial statements. The proxy statement was filed with the Commission on September 30, 1969 and mailed to NSMC's shareholders. Among the matters noticed therein for action at a special stockholders meeting to be held on October 8, 1969 was the approval of a merger of NSMC with Interstate National Corporation ("Interstate"), a publicly owned company. Substantially the same proxy statement was also mailed to Interstate's shareholders. The shareholders of both companies voted to approve the merger. Under the terms of the merger agreement, which was annexed to the proxy statement PMM was to deliver at the time of the closing, and before consummation of the merger, what is commonly called a "comfort letter," stating that:

> ". . . on the basis of a limited review, but not an audit, of the latest available unaudited interim financial statements of NSMC and its subsidiaries, consultations with responsible officers of NSMC and other specified procedures and inquiries (including all such procedures as they consider necessary under the circumstances in connection with such limited review), they have no reason to believe that the unaudited interim financial statements of NSMC as of May 31, 1969, and for the nine months then ended, were not prepared in accordance with accounting principles and practices consistent with those followed in the preparation of the August 31, 1968 audited financial statements or that any material adjustments of such unaudited interim financial statements are required for a fair presentation of the results of operations of NSMC and its subsidiaries or that during the period from May 31, 1969 to a specified date not more than five business days

[16] Included in these amounts was the Pontiac commitment of $1.2 million.

prior to the Effective Date there has been any material adverse change in the financial position or results of operations of NSMC and its subsidiaries taken as a whole."

The closing date for the Interstate merger was scheduled for October 31, 1969. At the time, PMM's Washington office was in the midst of its audit engagement for the fiscal year ended August 31, 1969. In the course of this examination, the auditors determined that significant adjustments had to be made to NSMC's financial statements. Certain of these adjustments were determined to be applicable to the May 31, 1969 nine-month financial statements—a subject of the required comfort letter. The effect of the adjustments PMM considered applicable to the nine-month statements was to reduce net income as set forth in the proxy statement for the unaudited nine-month period from a $700,000 profit to a net loss of about $80,000.

In light of the fact that PMM would not be able to give the "comfort" required by the merger agreement, the Firm's Department of Professional Practice in New York City was consulted on October 31, 1969, the day of the closing. An unsigned draft of PMM's letter setting forth the adjustments considered by them to be necessary was provided to the New York office of NSMC's outside legal counsel, where the closing was to take place. Sometime on the afternoon of October 31, before the merger was consummated, PMM informed NSMC and its outside counsel by telephone that an additional paragraph would be added to the letter which would state that if certain necessary adjustments had been made at May 31, 1969, the unaudited consolidated statement of earnings for the period would have shown a net loss for the consolidated operations of the company and that the company as it existed on May 31, 1969 was expected to "break even" for the fiscal year.

At this time, PMM (which was consulting its own counsel as to what steps it should take) understood that the draft of its comfort letter, which it represented to be still incomplete, was being reviewed by representatives of both Interstate and NSMC and their respective outside legal counsel and that all parties would await the delivery of a signed, final copy of the comfort letter before consummating the merger.

Later the same afternoon PMM called NSMC's outside counsel to state that the firm was issuing a final version of the letter to which had been added a further paragraph expressing PMM's belief that the companies should consider submitting corrected financial information to the shareholders before proceeding with the merger. At this time, contrary to its prior understanding, PMM was informed that the merger had been consummated without awaiting the final text of PMM's letter.[17] PMM delivered a signed copy of the final version to the office of NSMC's outside counsel before the close of business on October 31, 1969. On the next business day, November 3, 1969, PMM mailed copies of its final signed letter to eacn of the boards of directors of NSMC and Interstate (some of whom in both instances were outside directors) and NSMC's outside counsel which had represented NSMC at the closing and to the law firm representing Interstate at the closing.

PMM took no further action, believing that it had satisfied its professional obligations by manifesting its concern to management of NSMC and to the directors and attorneys of both companies, and having been advised by its own counsel that further disclosure might violate state laws and the AICPA Code of Professional Ethics relating to auditor-client confidentiality.

We recognize that the action taken by PMM was considerable, especially in the face of what appeared to the Firm to be countervailing positions taken by two prominent law firms. PMM's letter communication to both boards of directors was appropriate and put them in a position to take necessary action. Nonetheless, we believe that independent auditors in such circumstances should insist on revised financial statements being sent to shareholders when

[17] The comfort letter, after setting forth the basis on which it was issued and the adjustments PMM considered necessary, stated in part:

"Your attention is called, however, to the fact that if the aforementioned adjustments had been made at May 31, 1969, the unaudited consolidated statement of earnings of National Student Marketing Comporation would have shown a net loss of approximately $80,000. It is presently estimated that the consolidated operations of the company as it existed at May 31, 1969, will be approximately a break-even as to net earnings for the year ended August 31, 1969.

"In view of the above-mentioned facts, we believe the companies should consider submitting corrected interim unaudited financial information to the shareholders prior to proceeding with the closing."

they are professionally associated with such statements, whether audited or unaudited. Further, while we believe that primary responsibility rests with management and directors of public companies, where they refuse to resolicit shareholders, under these circumstances, we believe that independent public accountants have an obligation to notify the Commission. We believe that such action is protected by the policies underlying the federal securities laws against any complaint that state statutory or ethical confidentiality provisions had been violated.

1969 Financial Statements

On or about December 1, 1969, NSMC mailed to its shareholders, and others and filed with the Commission, its annual report containing audited consolidated financial statements for the fiscal years ended August 31, 1968 and 1969. Although the auditing procedures followed by PMM with respect to the 1969 statements represented a change from 1968 in that the fixed fee programs were confirmed in writing with NSMC's clients, accounting for the fixed fee programs continued to be on the same percentage of completion basis which the Commission, for the reasons stated above, concluded was inappropriate.

In addition, NSMC's 1969 financial statements reflected extraordinary gains in the amount of $370,000 from the sale of two subsidiaries. The transaction was described in Note 3 to the company's financial statements for the fiscal year ended August 31, 1969 as follows:

> "Subsequent to August 31, 1969, closings were held with respect to the sale of all of the stock of Collegiate Advertising, Ltd. and Compujob, Inc., wholly-owned subsidiaries. The subsidiaries were sold to employees of the respective companies. As to Collegiate, the consideration received was $220,000 represented by five-year 8% personal notes, secured by 3,200 shares of the company's common stock, and as to Compujob, the consideration was $225,000, represented by one-year 5% personal notes secured by 4,500 shares of the company's stock. The employees who purchased Compujob had originally sold it to the company. In the opinion of counsel in both transactions negotiations and agreements of sale were in effect consummated prior to August 31, 1969, and title to the stock and all of the risks and benefits of ownership thereof passed to the purchasers on August 29, 1969."

The auditors were first informed of these transactions during their examination, well after the close of the fiscal year. Although PMM knew the closings of these transactions did not take place until November of 1969, it was represented to them that the basic terms had been agreed prior to August 31, 1969. PMM was further aware that the parties were considering several different methods of structuring the transactions and, indeed, had been shown several different forms of agreement with respect to the sales prior to the November closing. In the auditors' view, the structure of the transaction was more a purchaser's problem and the auditor's concern was to assure himself that risks and benefits of ownership passed from NSMC to the purchasers prior to the end of the fiscal period in which the transaction was to be recorded. Accordingly, the auditors sought and received legal opinions on the issue of passage of title from the attorneys for the purchasers who, it was expected, would have had first hand knowledge of the relevant facts as participants in the negotiations. In addition, PMM sought and received confirmatory opinions from NSMC's outside legal counsel which stated that the effect upon NSMC and the purchasers of the two subsidiaries was "as if" ownership of the shares of the companies had been transferred thereunder prior to August 31, 1969.[18]

PMM was aware that each of these subsidiaries was operating at a substantial loss and that the purchasers were employees of NSMC. In order to alleviate their concern as to why the purchasers wanted to acquire what were in effect losing companies, they sought and received written representations from the three principal officers of NSMC confirming that there were no indemnification or repurchase commitments given to the purchasers.

We believe that the auditors placed far too great a reliance on the opinions of counsel and the representations of management with respect to these transactions. Although the auditors were misled, such deception does not relieve the auditors of their professional obligation to conduct

[18] The engagement partner explained in a letter he wrote to NSMC's controller at the time that "we are agreeing to the transaction being recorded as of August 31, 1969 only in reliance upon legal opinion as to the passage of title and the propriety of recording the transactions at that date. Furthermore, as we expressed during said meeting and in other occasions, we will require adequate disclosure of the transaction and of our reliance on the opinion of White & Case in the notes and probably in our accountants' report."

their examination in accordance with generally accepted auditing standards ("GAAS"). As we said in a similar situation in *Accounting Series Release No. 153,* it appears that the auditors

> ". . . failed to fully appraise the significance of information known to [them] and to extend sufficiently [their] auditing procedures under conditions which called for great professional skepticism."

We believe the "sales" of these subsidiaries were, in fact, sham transactions.[19] We believe that if PMM had sufficiently extended its audit procedures it would have discovered that (1) in neither case had negotiations commenced until after the close of NSMC's fiscal year;[20] (2) in the case of one subsidiary, NSMC had, by various side agreements, agreed to assume *all* risks of ownership after "sale" and, with respect to the other subsidiary, NSMC had agreed to make various cash contributions and to guarantee a substantial bank line of credit after sale; and (3) in both cases the collateral to secure the notes had been given to the purchasers by officers of NSMC.[21]

TALLEY INDUSTRIES, INC.

This case arises out of a merger in May 1970 of Talley Industries, Inc. ("Talley"), a Mesa, Arizona based company engaged in the manufacture and distribution of various products, including products designed for the U. S. Armed Forces, with General Time Corporation ("General Time"). In connection with such merger, Talley's financial statements for the year ended March 31, 1969 (audited) and for the nine months ended December 31, 1969 (unaudited) were included in a joint proxy statement mailed on or about April 16, 1970 to shareholders of Talley and General Time. PMM had examined and issued a qualified report on the 1969 statements and consented to the inclusion of its report in the proxy statement. Immediately prior to the merger, PMM also had issued a comfort letter dated May 10, 1970 with respect to Talley's unaudited financial statements for the nine months ended December 31, 1969 which were contained in the proxy statement. Information obtained by the Commission in a non-public investigation indicates that the foregoing financial statements and comfort letter were materially false and misleading. In addition, we believe PMM's examination did not meet professional standards.

Talley's financial statements were computed on the basis of: (a) Talley's projections of amounts of sales and expectation of new defense contracts in future periods for significant portions of Talley's business at its Mesa, Arizona operations, and (b) Talley's estimates of future production cost savings. In fact, Talley had no reasonable basis for expecting receipt of new contracts for production of its products in the amounts it projected or for future production cost savings in the amounts it estimated.

In view of the foregoing, we believe that both Talley's March 31, 1969 and Talley's December 31, 1969 financial statements improperly reflect inclusion in inventory of substantial costs in excess of those attributable to goods on hand at those dates ("excess costs"). The aggregate of excess costs amounts to $8.9 million at March 31, 1969 and substantially more at December 31, 1969. These excess costs (including those accumulated in 1969) were written off as of March 31, 1970 at the insistence of PMM.[22] To the extent that such excess costs were improperly included in inventory, cost of sales was understated and net income was overstated. The write-off of excess costs at the end of fiscal year 1970 was approximately $19 million before anticipated tax effect. In our view, under the circumstances present in this case, Talley should have reflected excess inventory costs in its profit and loss statements as incurred; the result of not having done so was to overstate Talley's earnings for the year ended March 31, 1969. If all of the excess costs had been

[19] It should be noted that the promissory notes given by the purchasers clearly state that they are non-recourse notes involving no personal liability therefor on the purchasers' part.

[20] The minutes of the NSMC Executive Committee meetings reveal that negotiations for the disposition of these two subsidiaries had not been authorized until October 20, 1969.

[21] Another instance where we believe PMM should have extended its audit procedures to inquire further into the substantive nature of the transaction relates to the accounting for the acquisition by NSMC of Consultants for Market Isolation, Inc. This transaction, which was accounted for as a pooling of interests in NSMC's financial statements for the fiscal year ended August 31, 1969, involved the sale for a substantial purchase price (approximately $1,360,000 in NSMC stock) of a company which had little or no economic substance. In our view, this acquisition was a sham transaction entered into by NSMC and the sellers, who were employees and stockholders of NSMC, in order to avoid recording as expenses payments to which the sellers were entitled under a sales representative agreement they had previously entered into with NSMC.

[22] We note that PMM's insistence on the write-off was with the knowledge under the circumstances that such a write-off would most likely lead to the civil and Commission litigation which in fact ensued.

written off as incurred, Talley's earnings for the year ended March 31, 1969 would have been $.74 per common share, compared to the reported figure of $1.71 per common share.

Talley's Accounting System

In 1969 Talley accounted for its cost of sales on a program basis ("program method") for fixed price U. S. Government contracts at its Mesa, Arizona operations. Similar products were grouped into a program. At fiscal year end (March 31, 1969) a gross profit ratio based on estimates was established and was used in the following manner: actual sales for the fiscal year were added to projected sales for the following year as determined by known backlog and projection by Talley's management of anticipated contracts and actual costs for the year's production were added to costs estimated by Talley's management to complete the sales projected for the following year. A gross profit ratio based on total estimated sales over total estimated costs was established and applied to the dollar amount of actual sales made in the audit year to determine the cost of sales for the year. Any costs incurred in the audit year in excess of the amount recognized as cost of sales in that year by this computation were carried forward as part of inventory. The gross profit ratio so determined, adjusted for actual manufacturing overhead, was used by Talley throughout the following fiscal year to compute cost of sales for unaudited interim periods.

In the financial statements examined by PMM for the fiscal year ended March 31, 1969, Talley had projected total sales for the year ending March 31, 1970 amounting to approximately $100 million, of which only approximately $24 million was backlog. Anticipated sales contracts were primarily for programs for pyrotechnics, starter cartridges, and bomb racks. Such treatment had the effect of including in Talley's Mesa inventory account at least $8.9 million of costs in excess of the projected total costs of contracts on hand as of March 31, 1969.

Talley's financial statements for the nine months ended December 31, 1969 (unaudited) showed nine months earnings computed on the same basis of projected sales and estimated production costs, which resulted in an overstatement of inventory and of earnings; however, such financial statements were based on:

(1) $100 million of projected sales for the Talley Mesa operation for the fiscal year ending March 31, 1970, when actual sales of only $18 million had been achieved for the nine months ended December 31, 1969, and it was evident that the projected sales level of $100 million for the fiscal year 1970 would not be achieved; and

(2) anticipated production cost savings which had not been achieved as of December 31, 1969.

Such projections were made by Talley without adequate substantiation and lacked sufficient documentation.

Talley's business at its Mesa operation was obtained as a result of government contracts awarded for defense products. Talley, in making projections of future sales, had to predict: (1) total dollar amount of future contracts for a particular product to be awarded by the defense agencies; and (2) the percentage of the total market for that product that Talley would be successful in capturing.

As to (1), although information was available concerning future contracts to be awarded in the form of Advanced Planning Procurement Information ("APPI") bulletins from the Armed Forces, and in some trade publications, projections were based largely on subjective judgments by management as to future government purchases. Reliance was not based soley on government announcements, but also on a number of unofficial sources, such as reports from Talley's field representatives, conversations with other individuals in government and industry, and in-house estimates of the government's future purchasing plans. Complicating Talley's problems in making accurate sales projections was the fact that not all anticipated defense product requirements listed by APPIs or reported in other trade sources available to Talley materialized into formal requests for proposals or bids. In some instances, reductions by Congress in appropriations cancelled programs in which Talley had projected it would secure contracts. Moreover, delays in approval by Congress of the appropriations bills sometimes seriously undermined the accuracy of some of Talley's projections of future contracts to be awarded.

As to (2) above, *i. e.*, Talley's projections of its share of the total market for a product, the predicitions were even more subjective than the judgments made in (1), because no official information was available as to an accurate determination of those manufacturers who would win bids. As to certain of these projections, Talley

had to estimate, among other things, whether it would be the low bidder. As to certain others, Talley's judgment was based upon its belief that the government had desired and/or would desire to have more than one source of supply.

Talley's production cost estimates of material, labor and overhead for the fiscal year 1970, used in computing Talley's cost of sales for its fiscal year ended March 31, 1969, were also made without adequate substantiation and lacked sufficient documentation. While the program method of accounting is acceptable in circumstances where contracts for future sales exist, or where the likelihood of future contracts may be documented with a substantial degree of assurance based on past experience or other factors, we do not believe that either of these conditions existed in this case.[23]

In view of what PMM realized was the crucial importance of the reliability and accuracy of Talley's projections of sales and estimates of production costs to a fair presentation of Talley's financial statements as a whole for the fiscal year ended March 31, 1969, we believe that the auditors relied too heavily upon the representations, projections and estimates made by Talley's management, and did not require sufficient documentation and evidential matter to enable them to review adequately the sales projections and cost estimates for reasonableness.

Accounting Controls and Use of Program Cost Method

A physical inventory of goods-on-hand and work-in-process was taken only once a year, at fiscal year-end, at Talley's Mesa operations, despite PMM's recommendation in 1968 to take inventory on a more frequent basis for selected programs.

No procedures or accounting steps were established by Talley or recommended by the auditors to adjust the cost of sales figures for interim periods on the basis of variances of actual sales and cost experience from the projections and estimates. Moreover, while information was available throughout the year on both actual sales and actual costs, their variance from projections and estimates was not computed as such by Talley and, in fact, Talley's management made no review of their impact on the validity of Talley's interim cost of sales figures.

The program cost method could be accepted for certain products with extended production cycles and large start-up costs and where there is a reasonable basis to expect the receipt of future or follow-on contracts. However, even assuming the predictability of such contracts, the use of estimates inherent in this system requires strong accounting controls with constant monitoring and the recording of variances between estimates and actual experience. However, Talley's cost system lacked the sophistication to monitor variances with respect to interim financial statements or, in any event, was not utilized by Talley to do so. Also, there was no documented evidence to substantiate the large amounts of start-up costs (such as research and development costs and tooling costs) expended by Talley to develop a major portion of its products.

In light of these facts, Talley should not have employed the program cost method for a major part of their programs such as starters and pyrotechnics. Of the $19 million in excess costs at March 31, 1970, $10.5 million was in the pyrotechnic program, $1.9 million in the starter program and $3.3 million in the bomb rack program.

Moreover, prior to April 16, 1970 when Talley mailed its proxy statement, it was known that Talley's actual sales for its Mesa operation for the nine months ended December 31, 1969 were only $18 million and it was then evident that the projected sales levy of $100 million for the year ending March 31, 1970 would not be realized. Accordingly, even assuming, *arguendo,* that Talley had been justified in embarking on use of the program cost method, by the date of the proxy statement it should have become quite obvious to Talley that the projections utilized in the computation of current earnings had proved so inaccurate and unreliable that continued inclusion of excess costs in inventory was clearly improper.

[23] Based upon our experience with respect to corporate disclosure on defense and other long-term contracting activities, we expanded the rules set forth in Regulation S-X to call for disclosure of greater detail in certain critical areas, particularly with respect to the nature of costs accumulated in inventories, the effect of cost accumulation policies on costs of sales and the effect of revenue recognition practices on receivables and inventories. Such amendments to Regulation S-X were adopted in Accounting Series Release No. 164, effective with respect to financial statements for periods ending on or after December 9, 1974.

The Role of PMM

PMM's report on Talley's financial statements for the year ended March 31, 1969 contained in the proxy statement is qualified as subject to the company's ability to obtain sufficient future contracts as referred to in Note 3. The relevant section of Note 3 states:

> "The Company bases its calculation of inventories and of cost of sales applicable to fixed price United States Government contracts on the costs (including administrative overhead) incurred and estimated to be incurred on the relative production programs. For the purpose of computing sales, these costs are prorated over the estimated total revenues for such programs. The estimates are based on actual contracts on hand and future contracts expected by management to be obtained. The resultant value of inventories on this basis at March 31, 1969 is approximately $8,900,000 in excess of the prorated cost of actual contracts on hand and such excess is believed to be larger at December 31, 1969 but management expects sufficient future contracts to be received to recover such excess."

Although the auditors' report on Talley's financial statements for the year ended March 31, 1969 included a "subject to" qualification with respect to Talley's ability to obtain future contracts, the notes to Talley's financial statements did not disclose:

(1) The dollar amount of future contracts ($100 million) which Talley's management was estimating would be obtained; and

(2) That recovery of the excess costs was also dependent upon Talley's realization of its projections of material amounts of savings in production costs. Thus, the report did not have a qualification that Talley's ability to recover the excess costs was subject to its ability to perform contracts in a profitable manner.

While it was clear from Note 3 that the excess costs arose because Talley's costs to date exceeded costs allocated to goods completed, in our view the footnote lack sufficient facts to permit an informed assessment of Talley's ability to recover the excess cost balance. Of great significance in this respect was the absence of disclosure of the amount of contracts its management was projecting for the Mesa operations, which projection for 1970 was $100 million or approximately four times Talley's previous year's actual sales, and which projection was used in computing Talley's 1969 earnings.

In August of 1969, PMM's senior on the Talley audit noted weaknesses regarding the accounting system utilized by Talley, stating in a draft letter to Talley management:

> "Our examination revealed that the estimated items used in the prior years' cost of sales computations were very inaccurate when they were compared to the actual results of operations for the current period. This inaccurate estimating is one of the reasons for the large discrepancy between book and physical inventory that presently exists. By overestimating future sales and underestimating future costs, prior years' sales have not been charged with their proper share of accumulated costs, causing a substantial amount of costs which are not supported by physical inventories, to be carried forward from year to year."

The draft letter further stated:

> ". . . Whenever possible, the use of estimates should be avoided. Such items as next year's overhead rate, future savings to be obtained from increased efficiency or improved procedures, or future selling prices and product mix should not have to be considered when determining the current year's costs of sales, since many of these items are not subject to reasonable estimation and tend to become guestimates which permit inaccurate and inconsistent financial reporting."

The PMM manager on the engagement (the senior's immediate supervisor) has testified that he discussed the projections with Talley officials and reviewed certain documentation from which he concluded that the projections were reasonable. However, it does not appear that such discussions were held with the Talley official who was responsible for the sales projections. Moreover, the manager did not document, as he should have, in PMM's workpapers in the Talley audit either such discussions or the scope of his review of the sales projections. The engagement partner disagreed with the senior on the audit with the result that the above draft letter (the substance of which was or should have been already known by Talley in any event) was not sent. The workpapers do not reflect this disagreement or the manner in which it was resolved.

PMM's Comfort Letter

On May 10, 1970, four days before the shareholders' meetings of Talley and of General Time, PMM issued a "cold comfort" letter to the directors of Talley which stated, in part:

". . . nothing has come to our attention which caused us to believe that . . . the aforementioned unaudited financial statements [for the nine months ended December 31, 1969] would require any material adjustments for a fair and reasonable presentation of the information shown."[24]

However, by the time the comfort letter was written, the auditors already knew the actual amount of sales ($24 million) for Talley's Mesa operations for the entire fiscal year. A PMM workpaper dated April 29, 1970 prepared in connection with its then annual examination of Talley's financial statements for Talley's March 31, 1970 fiscal year had scheduled both the $100 million projected sales and the $24.7 million actual sales for the Mesa operations. The auditors knew the importance of Talley's projections in Talley's cost of sales calculations for both fiscal year 1969 statements and the 1970 interim statements.[25] Knowing as it did by May 10, 1970 that actual sales had fallen far short of projected sales, the auditors should have insisted on amendment of the proxy materials, and, at a minimum, the comfort letter should have disclosed:

(1) that the actual sales for Talley's Mesa operations for the fiscal year ended March 31, 1970 were only $24.7 million;

(2) that computation of Talley's earnings for the nine months ending December 31, 1969 (unaudited) had been based on a $100 million projection of sales for the Mesa operations, which projection exceeded by a wide margin the actual sales of $24.7 million for the fiscal year ended March 31, 1970; and

(3) that a write-off of Talley's accumulated excess costs (included in inventory) would or might be necessary, such write-off resulting in material downward adjustment of earnings from those shown in Talley's financial statements for the nine months ended December 31, 1969 (unaudited), which financial statements had been included in the April 16, 1970 proxy statements furnished to shareholders of Talley and of General Time.

Prior to issuing the comfort letter for the information of the Board of Directors of General Time Corporation, PMM had had discussions with Talley management in which PMM inquired as to the status of the excess costs in inventory. The auditors were informed that, in the absence of a physical inventory as at December 31, 1969, Talley was not able to determine with accuracy the amount of the excess costs as of December 31, 1969. However, Talley's management estimated that the excess costs existing at March 31, 1969 had been substantially reduced and would be reduced to an immaterial amount by March 31, 1971. Talley's management further informed PMM it estimated that as a result of additional programs instituted after March 31, 1969, the aggregate amount of excess costs at December 31, 1969 and March 31, 1970 was somewhat greater than at March 31, 1969 but no more than $12 million in total (including the remainder of the excess costs existing at March 31, 1969). These representations by Talley's management were added to a letter which PMM was writing to the Commission. PMM had not verified such information nor did it represent that it had done so. In fact the estimates were unreliable and Talley's representations were incorrect. We believe that such use of PMM's name was inappropriate in these circumstances.

On May 14, 1970 Talley's acquisition of General Time was effected. In early June 1970, subsequent to the merger, PMM discovered during its audit of Talley's 1970 fiscal year-end financial statements that the excess costs of March 31, 1970 were in fact approximately $16.5 million (an increase of approximately $7.6 million from the previous year). Moreover, most of these costs did not appear to PMM to relate to new programs instituted since March 31, 1969 contrary to the representations previously made by Talley. In mid-June 1970, PMM informed Talley that it would be necessary to write off the $19 million of excess costs (discussed at page 41, *supra*) that had been accumulated in inventory.

Conclusion

In our view, the auditors' uncritical reliance on Talley management's unverified

[24] The auditor's comfort letter stated that the auditors had conducted no examination of Talley's nine month financial statements and that such letter was based solely upon PMM's having read the unaudited financial statements and Talley's minutes of board of directors' and stockholders' meetings and PMM's discussions with Talley officials.

[25] Both Talley and PMM personnel have testified that, in their view, Talley did not need to obtain all of the $100 million of sales during fiscal 1970 (*i.e.*, in their view the sales could be obtained over more than one year) in order to justify the carrying of the excess costs in inventory. We do not disagree. However, in the circumstances we believe a further review was necessary.

and undocumented representations as to future sales and costs was inappropriate because they related to such a material portion of its earnings for fiscal 1969.

While an opinion qualified as being subject to the outcome of a particular uncertainty is designed to communicate that uncertainty to readers of the report, it does not absolve the independent accountant of the responsibility for performing adequate audit tests and obtaining documentation in regard to the matter.

In this particular case, since Talley was using an estimate of future sales greater by several orders of magnitude than what the company had ever achieved on such products and an estimate of reduced future costs which was not supported by past experience in computing cost of sales for fiscal 1969, we believe, that absent substantial documented evidential support for Talley's sales projections and cost estimates, the auditors should not have accepted Talley's projections and estimates as a basis for even a qualified opinion.

Furthermore, since at a date six weeks after the close of the following fiscal year, the auditors' workpapers in the then ongoing examination of Talley's financial statements for its March 31, 1970 fiscal year showed that Talley had achieved less than 25% of the $100 million of sales which Talley had estimated would be achieved during that year and which Talley had used as a crucial element in estimating gross profit for 1969 and the first nine months of fiscal 1970, we believe that the auditors should not have issued a comfort letter in which they said that nothing had come to their attention which would cause them to believe that the financial statements would require any material adjustments.

We believe that in both the 1969 audit and the issuance of the comfort letter, PMM's professional performance in connection with the Talley engagement was deficient in terms of the standards of the accounting profession.

REPUBLIC NATIONAL LIFE INSURANCE COMPANY

PMM rendered unqualified audit reports on financial statements of Republic National Life Insurance Co. ("Republic") for the years 1970, 1971 and 1972. For the reasons set forth herein, the Commission believes that said statements were materially false and misleading in that they misrepresented the income and financial condition of Republic and failed to adequately disclose the nature and extent of transactions between Republic and Realty Equities Corporation of New York ("Realty") and Realty-related entities[26] during this period. Moreover, it is the Commission's view that PMM failed to apply auditing standards and procedures appropriate under circumstances which should have caused them to exercise a great degree of caution, particularly since during the time in question Realty was experiencing severe financial difficulties and the prior auditors already had identified some of the problems.

On May 10, 1971, PMM was engaged by Republic, a Texas life insurance company which then had about $10 billion of life insurance in force and over $400 million in net assets, to examine and report upon Republic's financial statements for the calendar years ending December 31, 1970 and December 31, 1971. Republic's prior independent auditor, Arthur Andersen & Co. ("Andersen"), had been terminated in late December 1970 and its 1970 financial statements previously had been issued in February 1971 without a report by an independent public accountant. They were accompanied by an "Actuarial Certification" signed by Neal N. Stanley, the company's actuary.

PMM rendered an unqualified opinion dated February 18, 1972, on Republic's 1970 and 1971 financial statements. PMM's report stated that:

> ". . . such financial statements present fairly the statutory financial position of Republic National Life Insurance Company at December 31, 1971 and 1970 and the results of its operations and the source and use of funds for the years then ended, in conformity with insurance accounting principles prescribed or permitted under statutory authority applied on a consistent basis. Insurance accounting principles vary in some respects from generally accepted accounting principles (see Note 1 of notes to financial statements)."

PMM's report on Republic's 1972 financial statements, dated February 6, 1973, was

[26] For purposes of this opinion, we consider transactions with Realty-related entities to include transactions with companies and individuals affiliated or associated with or otherwise related to Realty or involving assets or properties at one time owned or managed by or otherwise connected with Realty or which came to Republic in a transaction in which Realty participated.

also unqualified, and contained the same opinion concerning the statutory financial position of Republic National Life Insurance Company.[27]

We take issue with PMM's audits of Republic's financial statements only with respect to treatment of Republic's transactions with Realty and Realty-related entities in 1970, 1971 and 1972. For reasons stated hereafter, we believe that Republic's financial statements for 1970, 1971 and 1972 did not present fairly the financial position of Republic, the results of its operations and the source and use of funds during such periods. It should be noted that our views as to the issues of adequate disclosure and recognition of income in these financial statements of Republic do not turn on any distinctions between statutory insurance accounting practices and generally accepted accounting principles. Moreover, we believe PMM failed to gather sufficient competent evidential matter to determine the adequacy of the reserve for possible losses on mortgage loans and real estate for the year 1970, 1971 and 1972.

Republic's Realty-Related Investments

Beginning in January 1968, Republic made a series of investments in securities of Realty and First National Realty & Construction Corp. ("FNR"), a Realty-related entity, and made commitments to place and placed mortgages on real properties owned or operated by Realty and Realty-related entites. In addition, Realty and FNR purchased real properties from third parties who owned the properties subject to Republic mortgages. Many of the mortgages which Realty and FNR thus assumed had a history of late payments or other collection difficulties.

On August 3, 1970, the American Stock Exchange suspended trading in Realty's securities and Realty pubilcly announced an expected loss of $8.7 million for its fiscal year ended March 31, 1970. Shortly thereafter, Alexander Grant & Co., Realty's then auditors, disclaimed an opinion on Realty's consolidated financial statements for the fiscal year ended March 31, 1970, in part because of uncertainties as to Realty's ability to meet financing requirements with respect to substantial amounts of short-term indebtedness. Realty's financial difficulties continued throughout the ensuing period covered by the Republic financial statements discussed in this opinion.

As of September 30, 1970, Republic owned or was committed to purchase $24.6 million of stock, bonds and notes of Realty, FNR and other Realty-related entities. In addition, Republic had over $33 million in mortgage loans outstanding on real properties owned or managed by Realty or Realty-related entities. In view of Realty's financial difficulties, Republic was thus faced with a serious question as to its ability to recover in full its unsecured investment of $24.6 million. At this time, Republic apparently attempted to restructure its investments in a manner which gave the investments the appearance of greater security, by removing itself from the position of a substantial unsecured creditor of Realty. It thereafter engaged in a series of transactions with Realty which resulted in removing all of the bonds, notes and stock of Realty and FNR which Republic then owned in exchange for notes of four Realty-related entities which held assets purchased from Realty. These notes were subsequently exchange for mortgage loans on real estate properties and real estate itself. In these transactions significant additional funds were invested by Republic, the great portion of which was returned to Republic to pay prior obligations of Realty and Realty-related entities to Republic and in the form of interest income.

[27] On February 1, 1974 PMM withdrew its two reports on Republic's prior financial statements when, on the basis of PMM's ongoing examination of Republic's 1973 financial statements and information learned by PMM during the Commission's private investigation, it appeared to PMM that a substantially greater reserve, the amount of which was then still undertermined, for losses in Republic's investment portfolio would have to be established, and that the larger reserve would in part apply to earlier years since there was no basis for determining that all of these losses had been occasioned by events confined to 1973 alone. On February 4, 1974, PMM insisted that Republic issue a press release (revising a press release previously issued by Republic on that day) which stated that substantial adjustments to Republic's previously issued financial statements would be required and that such prior financial statements and PMM's reports thereon should no longer be relied upon until the necessary adjustments were made. PMM subsequently issued its report, dated April 12, 1974, on Republic's 1973 financial statements containing a substantial reduction of Republic's net gain from operations and net gain from operations per share as previously reported for 1970, 1971 and 1972. This April report stated that the financial statements had been prepared in accordance with statutory insurance accounting practices. In May 1974, PMM reported on Republic's financial statements on the basis of generally accepted accounting principles.

At December 31, 1971, Republic's financial statements included $9 million of bonds and notes of Realty-related entities, mortgage loans outstanding of $56 million on properties owned or managed by, or in some other way connected with Realty or Realty-related entities and $31.5 million in real estate which had come to Republic as a result of Realty-related transactions.

Republic's problems with its Realty-related investments continued in 1972, and Republic invested significant additional funds in transactions with Realty and Realty-related entities. Republic's aggregate Realty and Realty-related investments, contrasted to Republic's total reported statutory assets, were approximately as follows at year end 1970, 1971 and 1972:

Year	*Realty and Realty-related*	*% Total*	*Total Assets*
1970	$ 56 million	20.2	$277 million
1971	$ 97 million	23.5	$412 million
1972	$110 million	24.6	$448 million

This aggregate amount of Republic's Realty and Realty-related investments was not disclosed in Republic's financial statements for 1970, 1971 and 1972 or in PMM's accountants' reports thereon. We believe that such information was material to Republic's financial statements, particularly since by September 1970 Realty was experiencing severe financial difficulties which continued throughout the period covered by PMM's 1971 and 1972 audits of Republic.

Nor did the financial statements or notes thereto or PMM's accountants' reports on such financial statements contain the material information that at least 30% of Republic's reported income in 1970 (31%), 1971 (42%), and 1972 (30%) resulted from Republic's Realty-related investments. Moreover, for reasons stated hereafter, such income should not have been recognized at all.

In our view, PMM's auditors should have insisted that Republic make adequate disclosure concerning such matters; failing that, disclosure of such matters should have been made in PMM's accountants' reports together with appropriately qualified opinions.

PMM's auditors had been aware of the significant transactions between Republic and Realty as a result of their own audit work. Additionally, prior to issuance of PMM's initial report (dated February 18, 1972) on Republic's financial statements the auditors had reviewed workpapers prepared by Andersen, Republic's prior auditors, and had reviewed a letter dated November 6, 1970, addressed by Andersen to Republic's Board of Directors. The letter noted that as of September 30, 1970, Republic's investments and commitments in Realty and FNR totaled about $58 million, called to Republic's attention recently available information concerning Realty's financial difficulties and informed Republic that the ultimate recovery in full of Republic's investments in Realty and FNR as of September 30, 1970 was in doubt. In view of the above factors and the likelihood of material effects thereof on Republic's financial positions at December 31, 1970 and the results of Republic's operations for the year then ending, the letter set forth Andersen's belief that Republic's 1970 financial statements should include "complete and informative disclosure" of these matters. Examples of such disclosures included:

> "Segregation within the balance sheet of all investments in Realty and affiliates."
> "Information regarding commitments to Realty and affiliates together with appropriate description as to Realty's current financial condition."
> "Information relating to all significant transactions between Republic and Realty or its affiliates. . . ."

Andersen's letter also stated:

> "Republic has presently recorded approximately $2,000,000 of income from its investments in Realty and FNR during the nine months ended September 30, 1970. Although substantially all of such income has been collected in cash, it nevertheless has been offset by larger investments in Realty. Since realization of this income is dependent upon the ultimate recovery of Republic's investments in Realty and FNR, we do not believe current recognition of such income is appropriate."

In December 1970 Republic terminated Andersen's engagement as Republic's auditors, and Andersen did not audit the December 1970 transactions between Republic and Realty nor did they report upon Republic's financial statements for the year ended December 31, 1970.

In addition to the reserves discussed herein, Republic's 1970 and 1971 financial statements reported upon by PMM contained a Statement of Source and Use of Funds, not required under statutory life insurance accounting practices but insisted upon by the auditors as disclosure of investment portfolio difficulties experienced by Republic which in a "Note" at the end of the text thereof, stated:

"During the years ended December 31, 1971 and 1970 certain investments were exchanged for or converted to other investments. The details of such transactions (excluded from the above statement) are as follows:

	1971	*1970*
Bonds exchanged for real estate	$17,753,000	———
Bonds exchanged for mortgage loans	1,200,000	———
Mortgage loans converted to real estate	19,302,928	$2,350,395"

The following year, a "Note" to the Statement of Source and Use of Funds contained in Republic's 1972 financial statements stated as follows:

"During the years ended December 31, 1972 and 1971 certain investments were exchanged for or converted to other investments. The details of such transactions (excluded from the above statement) are as follows:

	1972	*1971*
Bonds exchanged for real estate	———	$17,753,000
Bonds exchanged for mortage loans	———	1,200,000
Mortgage loans converted to real estate	$8,556,628	19,302,928"

However, neither Note explained that the "certain investments" referred to therein were Republic's Realty-related investments or the fact that these investments were related to a company experiencing severe financial difficulties.

PMM correctly identified in late 1971 the primary problem area in Republic's financial statements as being Republic's investment portfolio and more particularly, Republic's Realty-related investments.[28] While the auditors expanded the scope of their examination in an attempt to deal with this area and insisted on establishment of a reserve for possible losses on mortgage loans and real estate of $7 million at December 31, 1971 (approximately $5 million of which was attributable to Realty-related investments) and $7 million at December 31, 1972 (all attributable to Realty-related investments), it failed to come to grips with the basic auditing questions.[29] PMM made a judgment that establishing the $7 million reserve for possible losses on mortgage loans and real estate essentially mooted the disclosure question. We believe, however, that judgment was not correct in light of the then known circumstances. In our view, the above-quoted notes and the establishment of the reserves was not an adequate substitute for disclosing Republic's relationship with Realty and the transactions they had engaged in. No specific explanation was given that some or all of

[28] While PMM was able to identify this problem area as a result of its own examination, it should not have acquiesced in Republic's request that it complete its own field work before it reviewed the prior auditors' workpapers. As it turned out, the information came so late that PMM's response was inadequate to the situation. As set forth in an earlier opinion, *In the Matter of Touche Ross & Co.*, ASR No. 153 (1974), it is important that successor auditors "obtain access to and carefully review the results of the predecessor's work." In our judgment, this includes a timely review which should be initiated by the successor auditor at the inception of the engagement. We believe this is necessary to assure an adequately planned audit program which would take into consideration those significant areas of controversy that may have been uncovered as a result of such review.

Mortgage loans unrelated to Republic's Realty-related investments were the subject of conferences between Andersen and Republic. The conferences were recorded by Andersen in memoranda which were not seen by PMM. We thing that all papers having a relationship to the successor auditor's responsibilities should be made available by the prior auditors.

[29] In addition to this reserve, a Mandatory Securities Valuation Reserve ("MSVR") applicable to possible losses on stocks and bonds but not on mortgages or real estate was provided in the amount of $4.5 million for 1971 and $5.8 million for 1972.

the reserve was attributable in the judgment of the auditors to possible losses on Republic's Realty-related investments and Realty's name was not even mentioned in the financial statements or in PMM's reports thereon.

Although auditing of Republic's 1970 and 1971 financial statements was accomplished at the same time, PMM's examination of Republic's Realty-related investments focused on the investments which Republic had on its books at December 31, 1971 as a result of the numerous transactions between Republic and Realty in 1970 and 1971. Since these remaining investments were in great measure mortgage loans and real estate, PMM attempted to value the real estate and the collateral underlying the loans to determine whether Republic had sustained losses as a result of the 1970 and 1971 transactions. While this examination included consultations with Republic's management and a review of the appraisals, prepared by Members of the American Institute of Real Estate Appraisers, which Republic had on the properties in question, neither the appraisals nor PMM's examination sought to ascertain the purchase prices paid by Realty to third parties for these properties. These properties had been purchased by Realty and simultaneously sold or mortgaged to Republic at prices far in excess of what Realty had paid for them. Although PMM questioned the basis and validity of preparation of some of the appraisals (some of which were done on a "highest and best use" basis, assuming future development), it did not obtain sufficient evidence of the current value of the properties in question. As one example, in December 1971, Realty purchased a large tract of undeveloped land in the Adirondack region of New York State for $3,150,000 and Republic placed a $13,450,000 mortgage on this property at the same time. This was the largest mortgage on Republic's books at both December 31, 1971 and 1972. Also included in the 1972 financial statements was a $5 million leasehold mortgage to a Realty-related entity. This mortgage was secured by the leasehold interest in an aging industrial complex, the sole tenant of which had already given notice that it would not renew its lease. Also, the Commission's investigation revealed that this transaction was contrived by Republic and Realty so that the portion of the proceeds in the amount of $1.7 million of this loan could be used by Realty and Realty-related entities to pay Republic the principal and interest payments to become due on two previously existing loans which had been granted by Republic to Realty-related entities in late 1971. PMM's audit procedures during their 1972 audit did not reveal this design or alert them to all of the factors surrounding the making of this loan. Although PMM did raise questions concerning the source of funds for the $1.7 million principal and interest payments on the pre-existing loans, it did not learn that the new $5 million loan by Republic had been used for such purpose. Included in Republic's 1971 and 1972 financial statements were the results of several similar transactions. Considering the significant prior transactions between Republic and Realty and Realty's failing financial condition, we feel that PMM should have extended its audit procedures substantially more than it did in this area.

The result was that despite establishing a reserve of $7 million for possible losses on mortgage loans and real estate, Republic's Realty-related mortgage loans and real estate were substantially overvalued at December 31, 1971 and December 31, 1972.[30]

In this case, PMM was aware, or should have been aware, of the significance of these transactions with Realty and Realty-related entities. We consider it an auditor's duty to do more than just make a mechanical examination of the data underlying a particular transaction. The responsibility of the auditor also involves a duty to investigate the totality of the circumstances surrounding material transactions, individually and in the aggregate, and to seek out the significant information that affects evaluation and decisions. In the instant case, PMM should have examined the circumstances under which Realty and Realty-related entities acquired the properties being mortgaged to Republic and should have insisted upon receiving appraisals based upon current value. Had PMM conducted an appropriate audit, it should have discovered the unusual nature of these transactions and the need for more complete disclosure.

[30] Republic concluded in its statutory financial statements for 1973, which were accompanied by PMM's report dated April 12, 1974, that the reserve for possible losses on mortgage loans and real estate at December 31, 1973 was $25,000,000 after reductions of the carrying value of certain assets aggregating $8.5 million and not recognizing as income amounts aggregating $11.8 million. The possible losses related principally to Republic's Realty-related transactions.

Many of these transactions between Republic and Realty and Realty-related entities were less than arm's length and many of the characteristics commonly found in what are usually referred to as "related party" transactions. It should be recognized that related party transactions are not limited to any particular type of classification. Rather, they can take an infinite number of forms including some of those engaged in by Republic and Realty-related entities. Auditors must be alert to these types of transactions, which frequently are the subject of one form of management deception or another. Auditors should be especially alert to these possibilities where there exists some ongoing relationship, such as existed between Republic and Realty.

PMM's Workpapers

As set forth above, we believe that Republic's financial statements significantly overstated the value of its Realty and Realty-related investments during the period covered by PMM's 1971 and 1972 audits. At the same time, Republic's reserve for possible losses on mortgage loans and real estate was significantly understated. The valuation of the investment portfolio was a crucial problem, and we believe that the inadequacies of PMM's 1971 and 1972 audits are reflected by the insufficient information in the workpapers as to the basis of calculations to support the adequacy of the $7 million reserve for possible losses on mortgage loans and real estate as at December 31, 1971 and 1972. The complications contained in the workpapers in support of the $7 million reserve as of the above dates, in our opinion, were not supported by sufficient evidential matter that would result in a conclusion that this account was fairly stated.

Income Recognition

In 1970, 1971 and 1972, Republic recognized substantial amounts of income which came largely out of the funds which Republic was advancing to Realty and Realty-related entities in those years. To the extent that PMM was aware that interest on many of Republic's Realty and Realty-related investments would not have been paid currently in the absence of such advances by Republic, serious questions should have been raised by PMM as to the propriety of recognizing such income on a current basis. PMM's determination that recognition of this income was not improper was based upon their attempt to value the Realty-related investments that Republic received. The auditors took the position that because possible losses on Republic's major Realty-related investments had been identified and provided for by the $7 million reserve and the MSVR, that there was no basis for refusing to allow Republic to recognize income from such investments. This judgment, although having some theoretical support, was only as good as the valuation of the investments that Republic held. In our view of the circumstances in this case, the auditors did not sufficiently extend their audit procedures beyond their review of the appraisals referred to above to determine the adequacy of the collateral for the Realty-related mortgage loans and, in fact, such collateral was substantially overvalued. Accordingly, we believe that in these circumstances such income should not have been recognized. Where interest is not being paid currently, it may be appropriate under some unusual circumstances to recognize interest income currently on adequately collateralized loans, but such circumstances generally will be very exceptional.

PMM's Review Procedures

In late 1972, PMM instituted a procedure whereby all of its reports on audited financial statements issued after December 31, 1972 would be reviewed by a second partner pior to issuance, primarily to give additional assurance of compliance with PMM policy regarding the form and content of the report and the accompanying financial statements. Thus, the report dated February 6, 1973 with respect to Republic's 1972 financial statement was one of the first to be subject to this so-called pre-issuance or "cold" review procedure.[31]

As part of the procedure, the engagement partner was to prepare for the reviewer a memorandum regarding the potentially critical areas of the audit and an indication of the engagement partner's satisfaction with the audit in each of those areas. The procedure did not normally contemplate a review by the second partner of any of the underlying audit workpapers, nor did it place upon him any responsibility for the adequacy of the audit or the appropriateness of the financial statements and

[31] This pre-issuance review should not be confused with a different reviewing procedure of PMM referred to elsewhere herein as "SEC review", which relates to the review of certain filings with the Commission.

related disclosures—such responsibility remained with the engagement partner who conducted the audit.

In his memorandum in early 1973, the engagement partner for the Republic audit identified, as the "main problem" in the audit, Republic's investments in Realty-related entities. In this connection, he stated:

> "The main problem area from an audit standpoint is investments. This company has some real problems in mortgage loans, certain bonds and real estate owned, most of which arose through dealing with Realty Equities Corp. I not only reviewed the investment workpapers in detail but also reviewed the loan files on new loans this year, held lengthy discussions with VP-Investments regarding problems and solutions and personally directed the audit of investments."

The memorandum did not mention, nor did the second partner making the pre-issuance review learn, that Realty was in severe financial difficulties and that the prior auditors had raised a number of questions with respect to Realty-related investments.[32]

THE PENN CENTRAL COMPANY

On February 1, 1968 the Pennsylvania and the New York Central railroads merged and became the Penn Central Transportation Company ("PCTC" or "Transportation Co."). PMM became the auditors of the merged company and issued a report on the results of PCT on both a consolidated and a "company only" basis for 1968. During 1969, Penn Central Co., a holding company, was formed and acquired all of the stock of PCTC. For 1969, PMM issued a report on the results of Penn Central on a consolidated basis and PCTC on a "company only" basis.[33]

On June 21, 1970, the Penn Central Transportation Co. filed a petition for reorganization under the bankruptcy laws. An investigation conducted by this Commission following the filing of the petition revealed that Penn Central management[34] had engaged in a program of concealing the deterioration of the company which occurred in the post-merger period and which led to the filing of the petition in reorganization. A detailed description of the transactions, events and activities preceding the filing of the petition is contained in the Commission's *Staff Report on the Financial Collapse of the Penn Central Company.*[35] Management's efforts involved misrepresentations as to the affairs, prospects, financial results, and value of assets of the Penn Central complex. The misrepresentations were made in many forms of communications to the investing public and shareholders.

While the financial statements upon which PMM reported did show a declining trend in 1969,[36] they substantially understated the magnitude of the real decline in the economic fortunes of Penn Central and did not reflect the cash drains which led to the collapse of the railroad when PCTC could no longer borrow funds.

The financial statements did not adequately present the financial condition of Penn Central because the economic substance of several transactions was not properly reflected therein and because there was insufficient attention given to the overall condition of the Company and its operations.

[32] These questions are reflected in the prior auditor's letter quoted above. The engagement partner apparently did not describe the differences the prior auditors had with Republic because he thought he was confronted with a different situation.

[33] PMM's reports were dated March 7, 1969 and March 12, 1970, respectively. Both reports were qualified as to the failure to provide deferred income taxes and were otherwise unqualified.

[34] Penn Central is used to identify the corporate complex in general without distinguishing the separate identities of Penn Central Co. or the Transportation Co. Penn Central Co. was essentially a holding company and neither it nor PCTC had a separate management.

[35] *The Financial Collapse of the Penn Central Company—Staff Report of the Securities and Exchange Commission to the Special Subcommittee on Investigations of the House Interstate and Foreign Commerce Committee, August 1972. U. S. Government Printing Office, Washington, D. C.*

[36] The consolidated results and the PCTC results were reported. Rail operations, which were most significant in appraising long run operating prospects, were not separately reported. The data are as follows:

*Earnings**	*Penn Central consolidated earnings**	*Penn Central Transportation Operations**	*(Loss) on rail operations**
Jan-Mar 1970	($17)	($63)	($101)
1969	$ 4	($56)	($193)
1968	$88	($ 5)	($142)
1967	$69	$ 9	($ 86)

* In millions

The principal means by which Penn Central inflated financial results for 1969 included the failure to include charges arising out of Penn Central's ownership of Lehigh Valley Railroad Co., failure to reflect current maintenance expenses of the New York-New Haven and Hartford Railroad Co. as charges against income, the improper inclusion of income from large real estate transactions by Great Southwest Corp. and the improper inclusion of dividends from certain subsidiaries. In 1968 the financial results were inflated by the improper inclusion of profits from the exchange of certain equity interests in real property for the stock ownership in Madison Square Garden Corp., the improper inclusion of income of the purported dividend comprising the common stock of a wholly-owned subsidiary of Washington Terminal Corp., the failure to record properly expenses connected with mail and baggage handlers, charges arising out of Penn Central's ownership of Lehigh Valley Railroad Co. and Executive Jet Aviation and the inclusion of purported profits from certain real estate transactions of Great Southwest Corporation. By acquiescing in these improper accounting practices, PMM, in our view, permitted Penn Central to misstate its financial position and operating results for the years 1968 and 1969.

In some of the items discussed below, PMM's position is briefly described.

Washington Terminal Company

PCTC, in 1968, included as part of its operating income what they considered to be a "dividend-in-kind" in the amount of $11,700,000 declared by Washington Terminal Company ("WTC") a 50% owned company carried on the cost basis by PCTC.[37] This income wes reflected in the results from ordinary operations and was part of the consolidated earnings of Penn Central and also part of the Transportation Company's operating results for the year. There was no separate disclosure in the financial statements or in the notes thereto that informed the reader of the nature of this transaction or of its magnitude. Absent this recordation as dividend income, consolidated earnings would have amounted to $78,573,000 as opposed to the $90,273,000 reported; and, PCTC's loss from ordinary operations would have amounted to $14,473,000 as opposed to the reported loss of $2,773,000.

The "dividend-in-kind" which was declared to its parent company was in the form of 100% of the stock of a new company formed for the purpose of receiving an undivided one-half interest in real property and air rights over the Union Station in Washington, D. C.[38] Both before and after the transaction, Penn Central owned a 50% interest in the Union Station property.

The Union Station property became the subject of an agreement with the United States Government for development of a Visitor's Center and the leasing by the National Park Service of such Center. The deed conveying legal title and an undivided one-half interest provided that WTC would continue to control the property during the period that the Visitor's Center was under construction.[39] The agreement provided that the National Park Service would lease the property for 25 years, after the owners had made significant alterations and improvements, which were expected to take two or three years. At the conclusion of the lease the property could be acquired by the National Park Service for $1.

PCTC recorded the $11,700,000 as its determination of the value of the stock distribution received.[40] This amount was based on an appraisal of the underlying property and the air rights.

PMM states that:

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[37] The other 50% owner of the stock of WTC was the Baltimore & Ohio Railroad Company.

[38] A similar dividend was paid in the form of 100% of the stock of a separate new company which was formed to receive B&O's 50% interest.

[39] The deed by which WTC conveyed (to the newly-formed corporation) the undivided one-half interest included the following reservation:

"Subject to the continued right of use, possession, operation and maintenance of the Union Station Building, concourse concession areas and related areas presently used for commercial operation by the Washington Terminal Co., its lessees, concessionaires, licensees, passengers, officers, employees, contractors, invitees, and visitors during the period of alteration and construction of the Visitor's Center parking facility and new passenger station contemplated by Public Law 90-264 and until the taking of full occupancy by the United States of America pursant to a lease covering the property herein described."

[40] McCandles Corporation had appraised the property and the air rights for the Baltimore & Ohio Railroad Co. at $27,000,000, so that based on that appraisal the value of a 50% was $13,500,000. The figure of $13,500,000 was reduced by PCTC to $11,700,000, to reflect its determination of the fixed cost of improvements and a discount for the period prior to commencement of rental payments.

Penn Central Transportation Company accounted for its investment in Washington Terminal Company on the cost basis, an acceptable method of accounting and the method most commonly followed in 1968. Since Penn Central Transportation Company accounted for its investment in Washington Terminal Company on the cost basis, in PMM's opinion any distributions from Washington Terminal Company necessarily were properly recorded in earnings when received; and since the distribution was a dividend-in-kind the proper method of recording it by Penn Central Transportation Company was at fair market value under then current accounting literature. In PMM's view, PCTC's obligations under the lease contract were fixed and accrued in its accounts, and therefore, there was no uncertainty with respect to the value of this dividend and income had to be recognized in 1968 when the dividend was received.

The Commission disagrees with PMM's position that all necessary elements were present to permit the recordation of income in 1968. In the Commission's view, this transaction was, in substance, a write-up of this asset on the books of the parent company. We believe that recognition by the Transportation Company of income in the amount of $11,700,000 in the form of a 100% stock distribution was improper since in substance the position of the consolidated enterprise was unchanged with respect to the use, possession, operation, and maintenance of the underlying subject property after the receipt of the distribution. Generally accepted accounting principles do not permit recording a transaction based on form when its substance is materially different.

The substance of the December 18, 1968 agreement was a promise on the part of the U. S. Government to purchase certain property after significant construction and alterations had been made to transform such property into a National Visitor's Center. In the Commission's opinion, recognition of income to PCTC under the circumstances outlined herein was inappropriate until the seller of Union Station had substantially performed its obligations.

The Commission also believes that if income in this amount was recorded in 1968, separate disclosure should have been made.

Madison Square Garden Transaction

Penn Central entered into a transaction in 1968 which involved a nonmonetary exchange within its investment portfolio that resulted in the company recording a gain in the amount of $21 million. This gain was reflected in income from ordinary operations and was part of the consolidated earnings of Penn Central and also part of PCTC's operating results for that year. There was no separate disclosure in the financial statements or in the notes thereto that informed the reader of the nature or magnitude of this transaction. Absent this gain, Penn Central's consolidated earnings from ordinary operations would have amounted to $69,273,000 as opposed to the $90,273,000 reported, and PCTC's loss from ordinary operations would have amounted to $23,773,000 as opposed to the reported loss of $2,773,000.

This transaction represented the exchange of Penn Central's 25% interest in Madison Square Garden Center ("Center") and its 55% interest in the Penn Plaza office building for a 25% interest in Madison Square Garden Corporation ("Garden"). Before the transaction, Garden owned 25% of the Center, 20% of the office building, the real estate on which the former Madison Square Garden had stood, and other minor assets.[41] Penn Central, in its filing with the Commission describing the transaction, indicated that its purpose was:

> "to concentrate and unify Penn Central's interests in the new Madison Square Garden Center and the office building—through the ownership of a substantial equity interest in Madison Square (Garden Corporation) which will be the beneficial owner and operator of those facilities."[42]

Penn Central, which received no cash, recorded the gain of $21 million on this transaction by valuing the Garden Stock received at $25.7 million (based on its average market price on the NYSE of $11.078 per share at the date of negotiations) and

[41] Madison Square Garden Corp. was essentially a holding company whose major assets consisted of its interests in Madison Square Garden Center, which in turn had the exclusive right to the use of the franchise and player contracts of the New York Rangers and New York Knickerbockers, and the Penn Plaza office building venture. The group of companies comprising the Madison Square Garden Corporation also owned a professional ice skating show and other real estate. The Madison Square Garden Corporation common stock had registration rights under the exchange agreement.

[42] Source—Schedule 13D filed by Penn Central Company received by the Commission April 1, 1969.

subtracting the $4.6 million carrying value of assets given up.[43]

It is PMM's position, as stated by it, that the exchange of PCTC's shareholdings and interest in two corporations (privately held) which owned and operated an office building and a sports center, for shares of stock in Madison Square Garden Corporation, a diversified holding company with over 36,000 shareholders, whose shares were publicly traded, constituted a substantive exchange of distinctly dieffrent kinds of assets and, in accordance with accounting theory then in existence, was an exchange of assets to which gain or loss must have been recognized. If no recognition were made of the exchange, the 1968 financials would not have shown the true results of management's decision to make the exchange, and future financial statements would not show the effect of management's decisions in the handling of its stock ownership in Madison Square Garden Corporation. In PMM's opinion, PCTC realized a gain of its investment in 1968 as the financial statement properly showed.

It is the Commission's opinion that the transaction represented the substitution of an investment in one form for essentially the same investment in another form. There was no change in economic interests in Center, the principal asset involved, and Penn Central's intent, as stated by it, was clearly not to dispose of its economic interest in the facilities exchanged.

We believe that PMM failed to recognize that in substance there were not sufficiently significant changes from a business viewpoint to warrant the recording of income on this nonmonetary exchange. Furthermore, it is the Commission's view that PMM should have required separate disclosure of the nature and amount of this transaction.

Merger Reserve: Separation of Mail and Baggage Handlers

In 1968, a Penn Central Transportation Company charged against a $117,000,000 merger reserve established in 1967, payments aggregating $4,672,000 made to certain mail and baggage handlers upon their separation from employment with PCTC.[44]

The Penn Central's predecessor railroads, the Pennsylvania and New York Central railroads, and their labor unions had entered into a Merger Protective Agreement, dated January 1, 1964, which provided that no one employed during the period from January 1, 1964 to the effective date of the merger would be terminated after January 1, 1964. A subsequent termination did not have to be merger related for the agreement to apply.

The $117,000,000 liability reserve which was established in 1967 was to provide only for wages to be paid to 5,600 employees who had been furloughed prior to the merger, but who, due to the Merger Protective Agreement, had to be recalled to service upon the consummation of the merger and had to be employed or paid thereafter until they left through natural attrition.[45]

Subsequent to the merger, Penn Central early in 1968 incurred a cost of $4,672,000 in separation payments to mail and baggage handlers made surplus as a result of curtailment of use of Penn Central's services by the U. S. Post Office Department. The basic accounting question faced by PMM was whether the payment of $4,672,000 made to the mail and baggage handlers, who had been separated from employment

[43] This was based on an agreement dated December 18, 1968. On the same date, Garden and Penn Central also entered into another agreement whereby Garden had agreed to sell and Penn Central agreed to purchase at $11.78 per share up to 180,538 shares of Garden's common stock. This sale and purchase agreement had the effect of continuing Penn Central's undertaking to loan funds to cover costs of construction of the 29-story office building that would be in excess of the construction loan. This was to be accomplished by Garden loaning the funds that it would receive from the sale of additional shares to Penn Central.

Penn Central originally had a 23% interest as a result of the transaction which was increased to 25% mainly through purchases under the stock purchase agreement.

[44] The $117 million reserve was the potential costs of recalled employees portion of an aggregate reserve totalling $275,421,985 for anticipated costs of the merger of Pennsylvania and New York Central railroads. The reserve was established in 1967 by the Pennsylvania Railroad Company with the approval of the Interstate Commerce Commission. It was established by making a charge to earnings in 1967 in the amount of $275,421.985 thereby reducing earnings in that year by that amount.

[45] There was another class of employees who were expected to be made surplus as a result of the merger. This group numbered about 7,800 employees and were to be made surplus as a result of consolidations, coordinations, elimination of facilities, and so forth. It was made up of employees who were working as of February 1, 1968, and were to be subsequently made surplus. All wages relating to such 7,800 employees were to be charged to current operations, no wages were to be charged to the liability reserve.

with PCTC, was chargeable to the reserve previously established, or chargeable to expenses for the period.

PMM seriously questioned the use of the liability reserve for the payments to the mail and baggage handlers which questions may have led management of PCTC to petition the ICC for approval to charge this cost to the reserve for ICC accounting purposes.[46] By a letter to the ICC dated January 23, 1969, Penn Central argued that such costs should be charged to the merger reserve because the payments to the mail and baggage handlers were directly the result of the labor agreements incident to merger, that they were unproductive of merger savings, and that the reserve was adequate in total amount.

PMM reviewed the letter to the ICC before it was sent and in the letter referred to in Footnote 46 above stated that if the ICC ". . . in its judgment deems the separations to be merger related and the costs incident thereto chargeable against the reserve, we would no longer have a basis for objection to a charge against the Merger Reserve for this purpose."

By letter dated January 29, 1969, the ICC replied as follows:

> "This will advise that a majority of Division 2 in conference today voted to grant the letter request filed January 23, 1969, for authority to charge an amount of \$4,672,000 expended during 1968 in connection with separation of mail and baggage handlers against the 'Merger Reserve' established in 1967."

In our view, the \$4,672,000 in separation payments incurred during 1968 as a result of the curtailment in services of mail and baggage handlers did not come within the original merger reserve criteria. The original merger reserve was created to provide for charges for payments to employees who had been furloughed prior to the effectiveness of the merger. The mail and baggage handlers were not furloughed to the effectiveness of the merger.[47]

In the Commission's opinion, even though the ICC was willing to permit the charge to the reserve for ICC purposes, we believe such amounts should have been reflected as a period expense during the year ended December 31, 1968 in the financial statements of the company issued to the shareholders. The accounting rationale for setting up the original \$117 million liability for the recall of surplus furloughed employees was that solely as a result of the effectiveness of the merger a liability had been created and the combined railroads had therefore suffered an expense (loss), unrelated to future operations, that had to be recognized. This accounting rationale does not apply to the facts leading to the \$4,672,000 in payments. The liability, and hence the expense, did not exist as of December 31, 1967 nor February 1, 1968 Nor was there a known contingent liability as of such dates. It is the Commission's view that PMM should have been more objective by resolving this issue independently of the ICC and that initial resistance of PMM to charging the reserve for these payments reflected the proper accounting and auditing posture.

Lehigh Valley Railroad Company

Prior to 1962, the then PRR, through subsidiaries, owned 44.4% of the outstanding shares of Lehigh Valley Railroad Company ("Lehigh Valley"). As a result of an exchange offer, PRR on February 28, 1963, became the record or beneficial owner of 89.9% of the stock and this was increased to 97.3% in 1964.

Lehigh Valley remained a 97.3% owned subsidiary of PCTC at the time of the merger of the PRR and NYC Railroads. In 1968, the Lehigh Valley losses were

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[46] By letter dated January 23, 1969, PMM advised Penn Central Company with respect to this charge, in part as follows:

"We have reviewed the facts concerning the separation of these employees and the data supplied to us with respect to the costs, amounting to \$4.672,000. It is our opinion that the Merger Reserve originally was not established to cover separations of this nature, and, accordingly, such costs would not constitute an appropriate charge against the reserve.

"We understand that you intend to petition the Interstate Commerce Commission to review the facts concerning the separation of the mail and baggage handlers and to rule on the question of whether such separations are, in fact merger-related. We have reviewed the letter addressed to the Commission by Mr. Saunders. Under the circumstances, if the Commission in its judgment deems the separations to be merger-related and the costs incident thereto chargeable against the reserve, we would no longer have a basis for objection to a charge against the Merger Reserve for this purpose."

[47] Penn Central had attempted to make a case to PMM that these mail and baggage handlers actually were intended to be furloughed prior to the date of the merger and would have been but for some unforeseen events and administrative oversight, and had they been furloughed prior to that date and recalled thereafter, the payments would have been chargeable to the reserve.

$6 million, and in 1969 the losses were $5.1 million, before an extraordinary charge of $1.2 million. The footnotes to the 1968 and 1969 Financial Statements contained in the Annual Report to Shareholders separately disclosed these losses. The Lehigh Valley results, however, were not consolidated with Penn Central's results during these periods.[48] Management's reason for not consolidating the operation of Lehigh Valley was their position that Penn Central's ownership was temporary since the ICC had required that Lehigh Valley be offered for affiliation with another railroad system.[49] Penn Central apparently relied on that ICC ruling as the basis for nonconsolidation,[50] apparently drawing its accounting support for nonconsolidation from the criteria included in *Accounting Research Bulletin No. 51.*[51]

The Commission concluded, based upon its investigation that neither C&O/B&O nor N&W ever had any interest whatsoever in acquiring Lehigh Valley; further, in the course of the investigation a management representative flatly stated that no one wanted to acquire Lehigh Valley and that it was not worth anything. In the Commission's opinion, therefore, Penn Central's ownership in Lehigh Valley could not reasonably be said to have been temporary, and, further, a significant write-down in the investment was required.

The Commission's investigation also included information gathered from "Moody's Transportation Manual" and from filings made by Lehigh Valley and contained in the public dockets at the SEC. These sources of public information revealed among other things, that for a 13-year period from 1957 through 1969, Lehigh Valley incurred consecutive annual losses; whereas for the 13-year period preceding 1957, Lehigh Valley had only two loss years. The trends as indicated in this published data, as well as the current amounts of advances being made to Lehigh Valley, clearly supported PMM's questioning management as to reasons why Penn Central's investment in Lehigh Valley should not be written down.

The audit workpapers of PMM for 1969 illustrate its awareness of the problem, the workpaper stating "Lehigh Valley—to be written down or reasons must be supplied." As a result, at the request of PMM, Penn Central made the following written representation to PMM in a letter dated March 12, 1970 concerning management's evaluation of this investment and their intention concerning its disposition.

> "One of the roads to which Lehigh Valley must be offered is the C&O and if the merger with the Norfolk and Western does not go through, the Lehigh Valley will have great strategic value to the C&O and we certainly should be able to come out well on our investment.
>
> "There are other alternatives we have in mind if this does not occur but it is too early and premature to determine to what extent, if any, an impairment may result in the investments."

PMM states that, in its opinion: (1) Lehigh Valley was properly not consolidated under the provisions of ARB No. 51; (2) that the carrying value of Lehigh was recoverable upon disposition; (3) that disclosure of the losses in 1968 and 1969 were clearly set out in footnotes to fully inform the reader; and (4) that the investment in and advances to Lehigh Valley were included in consolidated Penn Central investments and advances which in the aggregate had a market value well in excess of their carrying value. For all of the foregoing reasons, in PMM's view, not consolidating Lehigh Valley was appropriate and no write-down would have been required of this asset either in 1968 or 1969.

PMM further states that it was unaware that Penn Central was not reasonably likely

[48] The operations of Lehigh Valley were not consolidated in prior years; however, the financial statements for those years were not examined by independent public accountants.

[49] As noted in the footnotes to the 1968 and 1969 financial statements contained in the Annual Reports to shareholders, Lehigh Valley was not included in consolidation because the Interstate Commerce Commission "has required [Lehigh Valley] to be offered for inclusion in another railroad system."

[50] The Interstate Commerce Commission, in approving the merger of the Pennsylvania and New York Central Railroads in 1966, required PCTC to use its best efforts to offer Lehigh Valley to the C&O/B&O or to the N&W Railroads for inclusion in one of those systems, or absent such affiliation, for PCTC to continue to keep Lehigh Valley operational and possibly be merged eventually into Penn Central.

[51] The pertinent section of ARB No. 51 reads as follows:

> "Consolidation policy: 2. The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly of over 50 percent of the outstanding voting shares of another company is a condition pointing toward consolidation. However, there are exceptions to this general rule. For example, a subsidiary should not be consolidated where control is likely to be temporary; or where it does not rest with the majority owners (as, for instance, where the subsidiary is in legal reorganization or in bankruptcy)."

to divest itself of Lehigh Valley in the foreseeable future and, therefore, accepted management's accounting rationale in this regard and also accepted its reasons as to why the investment in Lehigh Valley should not be written down.

It is our view that PMM's auditing procedures should have included its seeking adequate evidence to support management's written representation as to the likelihood of divestiture. In both 1968 and 1969 PMM should have insisted that management furnish evidence that they had made offers to the C&O/B&O and to N&W, or that they were going to do so within a specific time period. PMM should have satisfied itself by further inquiry as to whether management had evidence of any indications of interest from these two railroads or from any other potential acquirer. We believe that PMM should have insisted on additional representations describing the specific alternatives that management had in mind in order for PMM to satisfy itself whether it was too early to determine, to what extent, if any, an impairment of value existed or would result.

In our view, Penn Central's ownership of Lehigh Valley was not temporary within the meaning of ARB No. 51 and, therefore, the operating losses of Lehigh Valley should have been reflected through consolidation. Failing such treatment, PMM should have insisted that the investments in, and/or advances to Lehigh Valley be written down since, in addition to Lehigh Valley's recorded losses there was substantial evidence in the Commission's opinion, as early as 1968, that Penn Central could not readily expect to cover its loans and advances to Lehigh Valley.[52] It is our opinion that PMM should have more critically examined management's assurances given in support of their representations that Lehigh Valley could be disposed of to another railroad system and without incurring a loss.

Executive Jet Aviation

In 1965, as part of a diversification program, the Pennsylvania Railroad ("PRR"), began investing in an air taxi service, Executive Jet Aviation, Inc. ("EJA").[53] PRR looked upon the investment as a means of entering into the air transport and air cargo fields, even though it was aware that the Federal Aviation Act prohibited railroads from engaging in such activities. PRR, however, made the investments in the hope that it would be able to have the aeronautics laws changed to permit it to engage in the air cargo business.

In 1966 EJA applied to the Civil Aeronautics Board for approval of its acquisition of Johnson Flying Service, a supplemental air carrier. In connection with this application, a CAB examiner found that PRR controlled EJA in violation of aeronautics laws. Pursuant to this finding, PRR submitted a plan of financing and divestiture which contemplated continued investment in EJA by PRR. In December 1967, the CAB held the plan to be inadequate, and ordered a complete divestiture.

Up to 1966 PRR had advanced approximately $14,000,000 to EJA. These advances continued at a rate of approximately $2.5 million a year during 1967, 1968 and 1969. In the last half of 1967, EJA embarked on a program of quietly acquiring interest in several foreign supplemental carriers. At the same time, Penn Central also was purportedly trying to find a buyer for interest in EJA, although its desire to retain some sort of "buy-back" rights was making this more difficult.

In mid-1968 U. S. Steel Corp. and Burlington Industries, Inc. entered into a memorandum of understanding with Penn Central whereby they agreed to purchase Penn Central's equity and debt interest in EJA, subject to EJA's receiving CAB approval to acquire Johnson Flying Service. However, Burlington withdrew from the agreement in December 1968 and U. S. Steel followed.

On June 4, 1969, the CAB instituted proceedings to determine whether EJA and Penn Central had violated provisions of the Federal Aviation Act. In October 1969, the CAB issued a cease-and-desist order, to which Penn Central and EJA consented. In addition to levying fines against both, the order directed EJA to divest itself of

[52] The investment and advances in Lehigh Valley by Penn Central at December 31, 1969 aggregated $49,493,000. Of this amount $23,025,000 was in capital stock, $4,125,000 in bonds, and $22,343,000 represented advances and other sums due. Of the latter amount, $16,395,000 represented advances made in 1968 and 1969.

[53] In 1965, as part of its diversification program, PRR, through a wholly-owned subsidiary, American Contract Corp., acquired 655,960 shares of class B, nonvoting common stock of EJA at a cost of $327,980, representing a 58% interest in the company's combined class A and class B shares outstanding. American Contract's largest investment in EJA, however, was in the form of loans and advances. Between 1964 and 1969, loans totalling $21 million were made by American Contract with funds provided to it initially by PRR, and later by Pennco.

control of foreign air carriers and Penn Central to divest itself of control of EJA.

EJA had sustained losses since it began operation.[54] EJA was unable to obtain outside financing unless Penn Central was willing to subordinate its investment. EJA's auditors, Lybrand, Ross Bros. & Montgomery (now Coopers & Lybrand), were unable to complete audits in 1968 and 1969 because of major problems. EJA's financial and operating condition was continuously adverse and, in the opinion of the Commission, the likelihood of Penn Central's recovery of its investments was highly unlikely.

Despite this situation, Penn Central's stated position, as reflected in a representation letter addressed to Peat, Marwick, Mitchell & Co., dated March 12, 1970 was as follows:

> "Pursuant to order of the Civil Aeronautics Board we must dispose of our investment in Executive Jet Aviation by March 1, 1971. Consequently, we are at this time carrying on negotiations with a number of interested parties with a view of disposing of our holding just as soon as practicable. It is a complicated situation and consequently negotiations as between interested parties vary widely. We anticipate that our holding will be disposed of in the relatively near future but only at that time will it be possible to evaluate intelligently the consideration to be received for our investment. It is almost certain that we will receive various types of securities in exchange for our stock."

PMM states that in its opinion it was not unusual: (a) for a company the size of PCTC to invest approximately $21,000,000 in what amounted to an experiment for expansion and for the investee company to suffer losses during its initial years; and (b) for a company which had suffered losses still to be considered to have substantial value to another company thereby enabling the investor company to recoup its investment or incur only a minor loss upon sale, this being particularly true of a start-up company possessing operating rights. The investment in EJA of approximately $21,000,000 was among total investments and advances of Penn Central of $453,239,000 in 1968 and $535,711,000 in 1969. In PMM's opinion investments and advances to consolidated subsidiaries and miscellaneous investments are to be considered as a group in determining whether a write-down should be made. The total market value of the investments and advances, including EJA, was in excess of the carrying value, and, therefore, in PMM's view there was no reason to write down the group of investments nor to write down any individual investment. Moreover, PMM states that it did not believe that management's representation was unreasonable and considered that it would have been improper to require that the investment be written down by an arbitrary amount when, in PMM's opinion, an estimate of the loss, if any, was not determinable. EJA eventually was sold in 1970 at a considerable loss, but in PMM's view this loss is not a true measure of the loss, if any, that would have been experienced had the sale occurred under normal circumstances prior to commencement of reorganization proceedings.

The Commission believes PMM did not go far enough in its examination to evaluate this asset. It was known to Penn Central and to PMM that EJA had been continually in need of operating funds; PMM was also aware of the CAB's order to Penn Central to divest itself of control of EJA, and it also knew of certain prior unsuccessful attempts by Penn Central to dispose of this investment. Under the circumstances described above, in the Commission's view the investment in EJA was seriously impaired and PMM should have viewed this investment differently from other Penn Central investments.

The Commission's investigation revealed that PMM was not furnished with financial statements of EJA. PMM, however, requested Penn Central management to represent to PMM its evaluation of Penn Central's position in this investment and its intention concerning the disposition of EJA. Penn Central's March 12, 1970 reply to PMM made no mention of any possible loss in this investment.

The Commission feels that since PMM was aware of EJA's financial difficulties, it should have insisted that management of Penn Central require EJA to prepare financial statements for PMM's review, and also should have insisted that Penn Central include in its representation letter the number and identities of the parties interested in acquiring EJA. Further, PMM should also have insisted that this representation letter include the status of the

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[54] 1965 loss: $992,000; 1966 loss $2,214,000; 1967 loss: $869,000; 1968 loss: $3,830,000; 1969 loss: $4,101,000.

various negotiations in support of management's statement that they had anticipated this investment would be disposed of in the relatively near future. In addition, PMM should have required management to represent to them the possible range of any gain or loss that could result from the nature and status of the negotiations with interested parties.

We believe that PMM should have expanded its auditing procedures in 1968 and 1969 to obtain the necessary competent evidential matter to enable it to conclude that this investment was fairly stated. In our opinion, based on all available evidence, it appears the loss in this investment should have been recognized in 1968 and 1969, and that PMM failed to exercise proper judgment in this regard.

Great Southwest Real Estate Activities

Great Southwest Corporation ("GSC") is a majority-owned (approximately 91%) real estate development subsidiary of Pennco, a subsidiary of PCTC, which is in turn a subsidiary of the Penn Central Company.[65] In 1968 and 1969 GSC management effected several income tax oriented syndications which were described as having included therein certain tax advantages to investors. These syndications resulted in large reported earnings by GSC and were reported to shareholders of GSC in its annual report to its shareholders and to the extent of Penn Central's ownership, they were also included in Penn Central's consolidated earnings and in PCTC's reported results of operations.[66]

At issue in this case were GSC's accounting treatment and financial reporting of three real estate transactions which were part of the 1968 and 1969 tax syndications. In one transaction in 1968 GSC sold a parcel of raw land known as the Bryant Ranch which was suitable for holding for subsequent sale or development and sale. In the other two transactions GSC sold in 1968 an operating amusement park known as Six Flags Over Georgia, and in 1969 an operating amusement park known as Six Flags Over Texas.

In December 1962, the Commission issued Accounting Series Release No. 95 ("ASR-95") to provide guidance in the application of generally accepted accounting principles to real estate transactions reported in financial statements to be included in documents filed under the federal securities laws. In that release we stated:

> "The recognition of profit at the time of sale, in accordance with generally accepted accounting principles, is appropropriate if it is reasonable to conclude, in the light of all the circumstances, that a profit has been realized."

We also indicated, in that release, that mere formal compliance with the technical legal requirement of a sale is not necessarily sufficient to justify revenue recognition, and that the substance of a transaction is the controlling consideration. In our opinion, the real estate transaction in question in this case involved circumstances of the type discussed in ASR-95 and were governed by the principles set forth therein dictating that there be no recognition of profit.[67]

In 1968 GSC sold the Bryant Ranch for $31,000,000 to a limited partnership formed to purchase the land. GSC reported the transaction as a sale and recorded a profit in that year of $8,558,176 and deferred $827,833 as a reported profit in 1969. The purchaser made a cash payment of $6,000,000 of which $600,000 was assigned to principal and $5,400,000 to prepaid interest. A note for $30,400,000 at a 7% annual rate was given for the balance, and under the terms of the note no principal payments were to be paid for the first 15 years after the transaction through 1983. There was no personal liability on the note and as required by California law, the only recourse was against the land. During this 15-year period, interest in the flat amount of $1,000,000 per year (less than that called for by the 7% rate) was to be paid. After 1984, principal payment plus accrued as well as current interest payments were to be made over a five-year period to amortize the note. Among other aspects of the terms of the transaction, GSC was obli-

[65] Pennsylvania Railroad Company, through Pennco, acquired the majority interest in GSC in the mid-1960's as part of the diversification program of PRR. For convenience, any reference to GSC includes Macco Corp., a 100% owned subsidiary of Pennco which was merged into GSC in March 1969.

[66] PMM was the auditor of GSC as well as Penn Central.

[67] Pursuant to an administrative proceeding, *In the Matter of Great Southwest Corporation*, Securities Act Release No. 9934 dated January 15, 1973, brought under Section 15(c)(4) of the Securities Exchange Act of 1934 and consented to by GSC, the financial statements of GSC for 1968 and 1969 have been restated and new reports thereon have been issued by PMM. PMM maintained in these new reports that the original accounting for these transactions had been proper.

gated under certain conditions to make certain improvements and also pay certain other costs.

In 1968, GSC sold its amusement park known as Six Flags Over Georgia for $22,980,157 and recorded a profit of $4,-813,400 on the transaction. In the Georgia park transaction, the purchaser, a limited partnership, made a cash payment of $2,-970,000 of which $1,500,000 was assigned to principal and $1,470,000 prepaid interest. The purchaser also gave a mortgage note for $21,000,000 at 7% interest. Principal payments in the amount of $700,000 yearly were to begin in 1975. In 1969, it sold its other amusement park known as Six Flags Over Texas for $40,000,000, and recorded a profit of $17,530,170 on the transaction. As to the Texas park, the purchaser, also a limited partnership, made a cash payment of $5,432,670 of which $1,500,000 was assigned to principal and $3,932,670 to prepaid interest. The purchaser also gave a mortgage not for $38,301,585. There were other aspects to the structure of these two transactions which included continuing exclusive management of the amusement parks by GSC as well as GSC's retention of certain risk of loss and opportunity for gain factors.[58] Except for a few differences both amusement park transactions were substantially similar.

In ASR-95, we stated that a prerequisite to revenue recognition is an effective exchange or conversion.

The Commission finds that applying the test of ASR-95 to the Bryant Ranch transaction, there was not a sufficient conversion of either GSC's or the purchaser's interest in the property to justify treatment of the transaction as a sale; and despite the formal aspects of the transaction, GSC immediately after the sale had essentially the same type and degree of control as it had prior to the transaction.

The Commission finds that one of the aspects of an exchange missing from the amusement park transactions, but necessary for an effective economic conversion, was the transfer of control.

The Commission finds that the other critical aspect of an exchange absent from the transactions was the transfer to the purchaser of the risk of loss and opportunity for gain. Upon the transfer of the amusement parks, GSC continued to have, in a functional sense, essentially the same type of degree of control over the business and management as it had before. GSC also continued to bear substantially all of the opportunity for gain. When the elements of control and retention of risk and opportunity for gain are considered together, it becomes apparent that GSC's position with respect to the amusement parks did not substantially change because of the sale transfers. As to these two transactions, the Commission believes that in economic terms, true exchanges did not take place, and therefore, it was not proper for financial reporting purposes to record the transactions as sales and recognize revenue thereon.[59]

PMM states that in 1968 and 1969 it was its opinion and still is that the three transactions mentioned above were *bona fide* sales and, in its view, met the criteria of ASR-95, which was an important consideration in PMM's decision that it was appropriate to recognize income on these transactions. PMM believes that these transactions involved substantial cash outlays by the purchasers and resulted in the transfer of the reward or burden of ownership from the seller to the buyer. It also believes that there was no continuing involvement on the part of the seller, except to make certain improvements on Bryant Ranch for which estimated costs were taken into account and to become the operator of the two amusement parks under a management contract with the purchasers. Moreover, aside from ASR-95, it is PMM's view that other then current accounting literature required that income be recognized in 1968 and 1969 when these transactions occurred.

In the Commission's opinion these three real estate transactions were structured by GSC with the concurrence of Penn Central's management in an unsuccessful attempt to meet the criteria contained in ASR-95. The Commission believes these transactions failed to meet the criteria of ASR-95 since, in substance, nothing happened from a business viewpoint to warrant the recording of sales and profits on these transactions. PMM should have recognized the attempts by management to structure transactions in a contrived manner to meet the technical criteria of existing ac-

[58] Moreover, GSC could not be removed as general partner prior to 1997 except under certain limited circumstances.

[59] See Securities Exchange Act Rel. No. 9934, *supra*, dated January 15, 1973, for the Commission's description and views of the three real estate transactions.

counting literature, when in the Commission's view, they did not. It is our opinion that PMM in its 1968 and 1969 audits of GSC and of Penn Central failed to exercise critical and independent judgment on this very important issue.

New York, New Haven and Hartford Railroad

As a condition of the merger of the Pennsylvania Railroad and the New York Central Railroad, substantially all of the properties and investments of the New York, New Haven and Hartford Railroad Company ("New Haven") were acquired by Penn Central as of December 31, 1968. In our view Penn Central in 1969 improperly accounted for New Haven maintenance costs thereby obscuring the true dimensions of New Haven's operating loss. As a result, there was a significant difference between the results of operations reported to the ICC and those reported to the public in 1969. Footnote 14 to the financial statements contained in the 1969 Annual Report to Shareholders discloses this difference.[60]

Penn Central asserted that the state of New Haven's equipment was very poor and had to be rehabilitated. On this basis, substantially all of the costs attributable to the upkeep of the road in 1969 were written off against a liability for rehabilitation cost established in connection with the purchase of the New Haven properties.

To charge the rehabilitation liability account with items chargeable as period expenses would be improper. As a result of making such charges Penn Central recorded total maintenance expenses in 1969 for New Haven which were significantly lower than those recorded by New Haven in the prior years.

Care must be taken to distinguish genuine rehabilitation charges from ordinary maintenance costs which may be incurred at about the same time. We believe that in this case insufficient attention was given to this distinction. The Commission is of the opinion that it would have been necessary to approximate the amount of expenditures deserving capitalization by comparing the total of maintenance and restoration costs incurred with the record of normal upkeep incurred in prior years. The historical record of approximate expenditures by New Haven for normal maintenance and capitalization items, as compared with 1969, follows (in millions of dollars):[61]

	Expense	*Capitalized*	*Total*
1969	$ 1.6	$35.9	$37.5
1968	34.6	0.6	35.2
1967	33.5	1.3	34.8
1966	33.3	0.5	33.8
1965	31.7	4.7	36.4

As a result of the staff's investigation of this area, the Commission believes that the audit examination by PMM was not sufficient to come to a conclusion that the $1.6 million was all of the general maintenance and repair costs that were to be charge against 1969 earnings.

Trucking Company Dividends

In 1969, PCTC caused one of its trucking company subsidiaries, New York Central Transport Co., to declare cash dividends of $12,000,000 to PCTC. PCTC also caused two other trucking companies to declare cash dividends in the aggregate of $2,000,000 to an intermediate subsidiary which then declared a dividend in a like amount to PCTC.

The Commission's investigation revealed that none of the trucking company subsidiaries had sufficient cash funds to meet these dividend declarations. As to the $12,000,000 in purported dividend payments from New York Central Transportation Co., PCTC instructed one of its banks to charge PCTC's account and credit the account at that bank of New York Central Transport Co. Simultaneously, New York

[60] Footnote 14 reads as follows:

"(1) Shares issued in December 1968 in connection with the acquisition of New Haven properties have been reflected in the accompanying financial statements at $41.125 per share, the average fair market value of the stock during the period of negotiation of the acquisition agreement; whereas the Commission [ICC] has ruled that such shares be valued at $87.50 per share, the value determined by the Commission [ICC]. The difference in purchase price has been reflected partly as a deferred credit of $23,077,000 and partly as additional paid-in capital of $21,284,000 in reports to the Commission [ICC]; whereas a liability of approximately $40,000,000 for rehabilitation and other costs assumed in connection with the acquisition of New Haven properties has been reflected in the accompanying [GAAP] financial statements, but not in reports to the Commission [ICC]. In 1969, the net loss for the transportation company, as reported to shareholders, was $21,986,000 less than the loss reported to the Commission [ICC] because of charge-offs against the liability for rehabilitation and other costs."

[61] From information contained in "Verified Statement (No. 10) of Stanley G. Jordon, Bureau of Accounts, Interstate Commerce Commission, Docket No. 35291".

Central Transport Co. instructed the same bank to charge its account for that amount and credit the account of PCTC. The bank followed the instructions.

At the time when PCTC was allegedly loaning funds to its subsidiary, PCTC did not have the necessary cash funds in that bank to cover the amounts transferred. New York Central Transport Co.'s books of account then reflected "advance payable" in the amount of $12,000,000 and its equity account was reduced by a like amount. While advances payable were substituted for equity belonguing to the sole shareholder on the books of New York Central Transport Co., the Commission concludes that the end result, in effect, did not give the 100% stockholder (PCTC) entity anything more than it had before, and the $2,000,000 dividend payment by an intermediate subsidiary was the same, in practical effect, as New York Central Transport dividend payment.

Notwithstanding the fact that these dividend declarations had no effect whatsoever on the consolidated earnings of Penn Central, the "company only" (PCTC) financial statements did include this dividend declaration in reported income.

PMM disclaims knowledge of the instructions given to the bank by PCTC or the New York Central Transport Co. However, PMM states that its view was, and is, that a subsidiary may make a dividend payment as long as it has accumulated earnings available for such dividend, even if no cash changes hands at the time and the parent company simultaneously or subsequently records advances to such subsidiary. With respect to intercompany transactions of this nature, it is PMM's opinion that such transactions are by their nature not arm's-length and that, therefore, in "company only" statements the important factor is disclosure. These dividends were included in a separate line item entitled "Dividends and interest—Consolidated Subsidiaries" which totalled $44,324,000 in the separate "company only" financial statements for 1969.

In the Commission's opinion, though PMM disclaims knowledge of the instructions given to the bank by PCTC or the New York Central Transport Co., PMM should have followed the procedure of tracing cash transfers in support of these transactions and, had it done so, it would have discovered the bank statements, and the bank's debit and credit memoranda accompanying such statements. This, in turn, would have led PMM to make further inquiry of management as to the factual circumstances underlying these transactions.

In the Commission's view, PMM's audit program should have been expanded in order to test intercompany transactions in greater depth. Such expanded testing was desirable since PCTC, the entity purportedly benefiting from this transaction, had its separate financial statements, which were reported on by PMM, included in the annual report furnished to shareholders by Penn Central.

In the Commission's view, since no cash changed hands and the dividend, though declared from retained earnings, was supported only by entries on the books of the bank, the subsidiary and the parent, and since cash funds were not available to support the entries of the bank or the companies, there was no basis for recognizing the dividend as income.

Conclusion

In this case, Penn Central management was engaged in an attempt to conceal the extent of the deterioration of the company. One of the elements in this program was the presentation of financial statements which did not reflect the adverse results of railroad operations and which minimized adverse trends in the total business. PMM should have understood what management was doing and, rather than acquiesce, should have resisted management's efforts.

Auditors should be alert for the kinds of warnings present in this case indicating that management seeks to conceal a deterioration in the affairs of the company.

One major warning given was management's effort to record income from transactions which were structured to give an appearance of being *bona fide* but which did not reflect a business or economic change which would justify the recording of income. The Washington Terminal dividend, the Madison Square Garden exchange, the trucking company dividends and the Great Southwest property sales illustrate this development.

In a period of crisis, management may structure transactions or seize upon opportunities which may serve as a vehicle for recording a gain in a particular period but which do not require that a company change its fundamental interest in the asset. Auditors must not allow their skepticism as to the essence of transactions to be

undermined. Instead, auditors should increase their vigilance when the proposal of such transactions raises questions as to management's intentions and as to the condition of the company.

Attempts by management to shift expenses from current accounts to reserve accounts or to capital accounts is also a cautionary note to accountants. In the items above, PMM allowed Penn Central to shift expenses under highly unusual circumstances, as in the case of the New Haven maintenance costs and the mail and baggage handlers.

Auditors also should be alert to the fact that where a company is experiencing a deterioration in its financial condition and results, it may seek to avoid writing down loss operations or investments and might seek to keep the current losses from such operations out of the consolidated financial statements. The Lehigh Valley Railroad and the Executive Jet Aviation situation described above are illustrations of that kind of desire by management, which must be resisted by auditors. The time when write-downs may be most needed is when a company is deteriorating and it is that very time when management will be particularly likely to want to avoid write-downs and will be willing to make representations to auditors to avoid the write-downs or to avoid consolidation of loss operations.

Another element in attempts by management to conceal in the financial statements the deteriorating condition of a company is the timing of recording large transactions. Some of the transactions described above were rushed to completion in the final moments of the financial period. Although this is not always a sign of improper management conduct, auditors should pay particular attention to such last minute transactions where the results of the company are declining or at a breakeven point as to profit and loss as in the Penn Central situation.

When faced with the possibility that management may be attempting not to reveal major adverse business trends, auditors must recognize this and review accounting matters with a particularly critical outlook to make certain that the financial results do not obscure the adverse business trend. The accountant must be certain that the treatment of all items fully conforms with the applicable principles. Moreover, the accountant must not view the treatment of items as acceptable merely because the treatment might be fitted within an applicable principle, and innovative treatments which tend to increase reported earnings or decrease reported losses must be scrutinized with particular care.

In our opinion, PMM, in auditing these statements, failed to heed the warning signs outlined above to insist on the application of appropriate accounting principles in the circumstances and to require adequate disclosures. In the Commission's view the statements were not a fair presentation of business facts.

Many of these transactions were presented to the auditors with a variety of sophisticated justifications supporting management's accounting methods to be used in recording the transactions. The Commission believes that PMM viewed these justifications too narrowly and did not consider whether the justifications were applicable in the circumstances. We consider it an auditor's duty to insist on meaningful application of accounting principles and disclosures in order that the financial statements reflect the business reality of the enterprise.

STIRLING HOMEX

Stirling Homex Corporation ("Stirling Homex") was engaged in the business of manufacturing and selling completely installed modular dwelling units, ready for occupancy. The concept employed by Stirling Homex was hailed as revolutionary in that the corporation attempted to integrate the many phases of home construction on a fixed site. The modular units were manufactured at a plant, shipped to a site and thereafter assembled into multi-family dwelling units.

Initially, Stirling Homex operated on a relatively limited scale. During the Company's first full year of operations, the fiscal year ended July 31, 1969, approximately 61% of its revenues[62] were derived from sales to entities controlled by the principal stockholders of the Company. For the succeeding two fiscal years nearly all revenue was derived from sales to local housing authorities and other non-profit entities who depended on Federal Government funding to finance the purchase of Stirling Homex dwelling units.

Stirling Homex became a public corporation on February 19, 1970 through a public

[62] Total revenues for 1969 were $9,600,000.

offering of 1,175,000 shares of common stock at $16.50 a share. On July 29, 1971 the Company made another public offering of 500,000 shares of cumulative preferred stock at $40 per share. In July 1972, the Company filed a petition under Chapter X of the Bankruptcy Act. Thereafter the Commission began an investigation of the affairs of the Company.

Information obtained by the Commission in that investigation into the affairs and financial reporting of Stirling Homex for the period 1970 to 1972, indicates to us that a registration statement and certain reports issued by Stirling Homex and filed with the Commission included audited financial statements for the seven-month period ended February 28, 1971 and for the fiscal year ended July 31, 1971 which were false and misleading and did not present fairly the consolidated financial position and results of operation of the Company in conformity with generally accepted accounting principles.

The consolidated statements of income of Stirling Homex for the seven month period ended February 28, 1971 included in the registration statement for the preferred stock[63] and the consolidated statements of income of Stirling Homex for the year ended July 31, 1971 contained in the Annual Report to Shareholders and Annual Report on Form 10-K for such fiscal year were false and misleading in that among other things:

—all modular sales of $12,493,000 for the February 28, 1971 period and $25,292,600 out of total modular sales of $29,482,271 for the July 31, 1971 period were improperly recorded in that the purported sales were not supported by required financing commitments;

—installation sales were overstated by approximately $3,723,000 out of a total reported installation sales of $5,137,000 for the February 28, 1971 period and $2,443,000 out of total installation sales of $7,200,000 for the July 31, 1971 period through the inclusion of sales from projects for which there were no commitments of financing and through Stirling Homex's improper reporting of approximately $1,000,000 as of February 28, 1971 and approximately $2,000,000 as of July 31, 1971 of excess installation costs as "cost overruns" reimbursable to the Company;[64] and

—general administrative and other expenses were materially understated by approximately $832,000 as of February 28, 1971 and approximately $1,000,000 as of July 31, 1971, as a result of the improper capitalizing of such expenses. Additionally, certain other expenses and construction costs were improperly capitalized.

PMM examined and issued unqualified reports on these financial statements. Although it should be noted that it appears that officers and other representatives of Stirling Homex, as well as others, intentionally deceived PMM by misrepresentation and concealment of material information and even the creation of a forged or spurious document, our investigation causes us to believe that PMM's examinations were not conducted in accordance with generally accepted auditing standards and we believe, as is detailed within, that the accounting methods followed by Stirling Homex were not in accordance with generally accepted accounting principles.

Stirling Homex accounted for its sales by separating the manufacturing and installation functions and by recording sales and income on the manufacturing aspect of the transaction upon the supposed assignment of manufactured units to the requirements of a particular housing agency customer. This was supported by a commitment of funding which was supposedly evidenced by receipt of a letter of designation, feasibility letter or other similar document from the local agency. Stirling Homex treated the letters or other documents from the local agencies as the equivalent of a financing commitment, and PMM accepted this concept.

In determining whether there existed a commitment of Federal financing, PMM relied on representations of Stirling Homex management, the Company's supposed experts on government housing programs, an opinion of outside counsel furnished by management, apparent concurrence of other reputable organizations dealing with the Company, and the belief that local housing authorities would not enter into contracts for projects without reasonable assurance that funding would be available. In fact,

[63] Also included in the registration statement were unaudited financial statements for the nine month period ended April 30, 1971. Such unaudited financial statements were false and misleading in that all modular sales of $18,183,000 for the April 30, 1971, period and approximately $4,656,000 out of the total installation sales of $6,382,000 for such period were improperly recorded.

[64] Had Stirling Homex not improperly capitalized these costs overruns from the installation portion of certain of its projects, it would have incurred substantial losses on completion of these projects.

as we think PMM should have understood, in almost all cases the letters or other documents were not a commitment for Federal financing and without Federal financing the revenue from the project was not assured.[65] The acceptance of these representations without further auditing work, particularly in the light of PMM's lack of experience in this area, resulted in improper recognition of sales revenues.

In summary, the Commission believes that the registration statement, reports and the financial statements contained therein portrayed Stirling Homex as a healthy, prosperous company with increasing sales and earnings when, in fact, that company was experiencing serious business problems and financial difficulties. Moreover, nearly all of Stirling Homex's sales and resulting accounts receivable were either improperly recorded or fictitious, and the Consolidated Balance Sheet included in the Annual Reports materially overstated assets by approximately $36,400,000 as a result of the inclusion in accounts receivable of sales from projects improperly recorded in the current and prior fiscal years.

Stirling Homex Revenue Recognition Policies

Stirling Homex contracted with its customers, primarily public housing authorities, to manufacture and install modular housing units resulting in a housing-development ready for occupancy. Modules were manufactured on an assembly line at Stirling Homex's manufacturing facility in Avon, New York. The modules were later to be shipped to a construction site where they would be assembled into two, three and four bedroom apartments. The apartments, in turn, would be assembled into larger structures consisting of two to five apartment, depending upon the requirements of an individualized site plan. The completed modules contained wall and floor coverings, drapery fixtures and all other necessary appurtenances in order to make the multi-module dwelling unit ready for occupancy when assembled.

The Company purported to follow a revenue recognition policy whereby revenue would be recognized on the sale of each module when manufacture of the module was completed and other events had occurred (including an irrevocable assignment of the modules to a specific contract and a firm commitment of funding for the project) which reasonably assured the ultimate collectibility of the sales price. For purposes of revenue recognition, Stirling Homex made an allocation of the contract price as between module manufacture and module installation segments and, upon the manufacture and assignment of modules to a contract, the Company normally recorded as modular manufacture sales approximately 55% of such total contract price. The accounts receivable resulting from the recording of sales upon completion of the manufacture of modules were carried on the books of Stirling Homex as unbilled (not invoiced to customers) receivables. The portion of the total contract price allocated by the Company to module installation was recognized on the percentage of completion basis as site preparation and installation work was performed.

During the period relevant here, Stirling Homex's customers consisted primarily of public housing authorities who looked to Federal government housing programs as sources of financing for their proposed projects. The programs involved were low rent housing programs under the turnkey program of the Department of Housing and Urban Development ("HUD") and a subsidized housing program under Section 236 of the National Housing Act administered by the Federal Housing Administration ("FHA"). In addition, Stirling Homex had one project under the rural housing program of the Farmers Home Administration ("Farmers Home") of the Department of Agriculture.

Most of Stirling Homex's projects in the period under consideration were under the HUD turnkey program. The initial step in this program, following the receipt of proposals including proposed prices from a number of applicants, was the issuance by a local housing authority ("LHA") of a letter of designation, designating an applicant, such as Stirling Homex, as the developer of a specified project subject to specified conditions. Subsequently, if the specified conditions were met, the letter of designation would be followed by a contract of sale between the LHA and the developer, countersigned by HUD to evidence its commitment to finance the project. Until HUD countersigned the contract of sale, there was no legally binding commitment of governmental funds by HUD. Stir-

[65] Some projects went forward to completion. Others, and they were larger, did not. The lack of completion resulted from a number of factors, including neighborhood opposition to housing at particlar sites and the inability of Stirling Homex to continue to obtain financing which led to its ultimate collapse.

ling Homex, however, began to manufacture modules and recognize income with respect thereto prior to the countersigning of the contract of sale by HUD and in most cases recognized income upon receipt of a letter of designation.

Commencing in the last quarter of the 1971 fiscal year, Stirling Homex recognized revenues on modules manufactured in connection with three projects which were intended to be financed under the Section 236 program of the FHA. The initial step in this program was the issuance by the FHA of letters of feasibility. These letters, although indicating the FHA's determination that the project was economically feasible and evidencing an intent to participate in the projects upon the satisfaction of certain conditions, did not in fact represent a legally binding funding commitment.[66] Stirling Homex, however, began to manufacture modules and recognized income when a letter of feasibility was received.

The third governmental program involved was the rural housing program of Farmers Home Administration, a branch of the Department of Agriculture. The one project purportedly financed under this program was the Greater Gulf Coast Housing Development Corp. project in Mississippi which is discussed below. Since the only purported commitment on the part of Farmers Home was a forged or spurious document committing $15 million, it is unnecessary to discuss the normal operation of this program.[67]

While reviewing Stirling Homex's 1971 registration statement, the staff of the Commission's Division of Corporation Finance questioned the reasonableness of recognizing sales revenues in advance of the date on which the Company was able to validly invoice a customer.[68] The staff requested that Stirling Homex revise its financial statements to defer recognition of income to that point at which the amount recorded was validly billable to a customer.[69] Had Stirling Homex complied with this request, its financial statements would have shown substantial losses from operations.

Instead, Stirling Homex requested a meeting with the Division of Corporation Finance to discuss its accounting practices. During this meeting,[70] and in a written statement submitted shortly after the meeting, Stirling Homex set forth its rationale for the allocation of the total contract price between the module manufacturing phase and the installation phase and represented that no sales were recognized with respect to module manufacturing unless the following five conditions were met:

"(1) The Company must be designated by the LHA non-profit sponsor or other agencies as the contractor for the project. This designation is supported by a formal commitment from the customer to the Company.

(2) The customer must have obtained and submitted evidence to the Company that a commitment of monies to fund the project has been obtained from the appropriate governmental agency under which the project has sponsorship.[71]

(3) The numbers and types of modules and the general site plan and improvements must be identified and be the sub-

[66] In addition to representations by Stirling Homex that the feasibility letters were a commitment of financing, PMM relied upon an opinion of counsel experienced in FHA matters, furnished to them by Stirling Homex management, which stated that, "In the trade and within the FHA organization, the feasibility letter is considered a binding, firm and reliable document" and "In summary, it is our opinion that the feasibility letter may reasonably be treated for accounting purposes as a basis for recognition of projected projects." The auditors did not fully relate the existing facts to this opinion.

[67] The materiality of this one project to the financial statements of Stirling Homex is vividly illustrated by the fact that sales on this project represented in excess of 60% of all module sales for the seven month period reflected in Stirling Homex's 1971 registration statement.

[68] Stirling Homex's unbilled receivables grew rapidly. On December 31, 1969, unbilled receivables were $644,918. At the end of the 1970 fiscal year, unbilled receivables increased more than seven-fold to $4.6 million. By July 31, 1971, the unbilled receivables were to increase by over $25 million bringing the total to $29.5 million. This increase of unbilled receivables created a distorted balance sheet since the current assets were composed primarily of these unbilled receivables.

[69] The relevant paragraph from the June 30, 1971 letter of comment reads as follows: "It is noted that the number of modules installed through April 30, 1971 is far less than the number manufactured through the fiscal year ended July 31, 1970. It appears to the Division that the registrant's accounting practices recognize income too far in advance of the date of billing to customers. It is requested that the financial statements for the current year be revised to defer recognition of income at least to a point no sooner than the amount is validly billable to the customer."

[70] At this meeting, which is discussed *infra*, a PMM partner responsible for the Stirling Homex account made a number of statements regarding Stirling Homex's accounting practices which we believe to have been in error.

[71] In its submission, Stirling Homex falsely represented to the staff—as it had to PMM—that a letter of designation from an LHA under the turnkey program represented such a commitment.

ject of the agreement between the Company and its customers.

(4) The Company must assign the manufactured module to a specific project and physically identify the module as being assigned to and reserved exclusively for the specific project and customer. (This identification was to be physically attached at the earliest stage of the manufacture of the module.)

(5) The module must be completed and be ready for shipment to the customer."

In short, it was represented to the Commission by Stirling Homex that before income was recognized in connection with module manufacture all events had occurred which reasonably assured the ultimate collectibility of the sales price properly allocable to such manufacture.

This representation was false and the Commission has concluded that with respect to virtually every project as to which the Company recognized income at the point of module manufacture, one or more of the five conditions stated above had not in fact been satisfied at the time of income recognition.

General site plans were rarely in existence at the time sales and income were recognized from the manufacture of the modules. Because irrevocable assignment of modules to a particular project was, in many instances, largely impossible until such site plans were developed, the purported assignment of modules to projects indicated in the computer runs and other records of the Company shown to PMM, was essentially a sham. In fact, the modules were maintained for the most part on an unsegregated basis and shifted and reassigned from project to project where the need arose.[72]

More importantly, in virtually every instance there did not exist a firm and legally binding commitment of Federal funds to finance the project. The non-profit entities (some of which were "shells") and the LHA's doing business with Stirling Homex did not have substantial funds of their own. The letter of designation and feasibility letters did not represent legally binding commitments of funds to purchase the projects and were subject to a number of stated conditions, such as selection and approval of a site, satisfaction of various zoning and building code requirements and agreement on an ultimate contract price. In almost all cases there was no commitment of funding to finance the projects at the time income was recognized.

In contrast to its representations to PMM and the staff of the Commission, that these conditions would routinely be satisfied, the Company, in practice, experienced great difficulties in finding acceptable sites (because of local opposition to the projects and other political and social problems) and in obtaining the zoning and building code variances necessary for its projects. In some instances it also had difficulties in reaching agreement on the ultimate contract price.

Moreover, the Commission believes that the allocation of the contract price as between module manufacture and installation was arbitrary and did not accurately reflect either the relative costs of each segment of the total sales price nor the relative profitability of the two segments. In fact, the actual costs of installation in most of the projects completed by the Company substantially exceeded those portions of the applicable total contract prices that Stirling Homex allocated to the installation work—at least, when there is taken into consideration the cost overruns improperly classified by the Company as accounts receivable.

Stirling Homex's accounting policy with respect to the recognition of sales and income upon completion of the manufacture of modules, which permitted the Company to front-end and prematurely report sales and earnings, was not in accordance with generally accepted accounting principles.[73] Following the manufacture of a modular housing unit for sale to an LHA, Stirling

[72] For example, on the RIT project, which Stirling Homex included in sales for the nine months period ended April 30, 1971, Stirling Homex "assigned" modules to the project for the purpose of recognizing income but they were not the type called for by the project. It was not until May, 1971 that the Company began manufacturing the appropriate modules.

[73] In 1970, the Accounting Principles Board issued APB Statement No. 4 which stated the general view on income recognition as follows:

"Revenue is conventionally recognized at a specific point in the earning process of a business enterprise, usually when assets are sold or services are rendered. This conventional recognition is the basis of the pervasive measure of principle know as realization."

* * *

"Revenue is generally recognized when both the following conditions are met: (1) the earnings process is complete or virtually complete, and (2) an exchange has taken place." While there are some exceptions to this rule, the necessary criteria for such exceptions did not exist in this case.

Homex still owned the modules and bore the risk of a loss.

The Commission believes that the percentage of completion method of income recognition was inappropriate with respect to the installation portion of the projects[74] since, among other things, the total time required for manufacture of the modules, preparation of the site and installation of the modules did not require more than a few months—assuming site selection, funding approvals and other local approvals were in fact in hand—and, therefore, the contracts probably could not be properly considered as long term contracts.

Retention of PMM

Stirling Homex began to search for a new accounting firm in January of 1971 after encountering resistance to certain of its accounting practices on the part of Harris Kerr Forster and Company ("HKF"), its auditors for the fiscal year ended July 31, 1970.* Stirling Homex apparently contacted a number of accounting firms, including members of the so-called "big eight." In late February of 1971, PMM was retained by Stirling Homex.

PMM was not aware of the approaches by the Company to other accounting firms or of the disagreements between HKF and the Company.[75] PMM was informed that the principal reason for the change in auditors was purportedly the Company's desire and that of its investment banker to obtain a "big eight" firm. PMM also asked HKF if there were any professional reason why PMM should not accept the engagement. In addition, PMM made inquiries concerning Stirling Homex and learned that the Company had reputable outside directors, legal counsel and bankers.

PMM was retained to perform an audit of Stirling Homex's financial statements for the seven months of the Stirling Homex fiscal year ended February 28, 1971. PMM was informed that such financial statements were to be included in the registration statement to be filed by Stirling Homex with the Commission. The account was assigned to a partner in PMM's Newark, New Jersey office. The audit work, however, for the Stirling Homex account was to be performed by the PMM staff located in Rochester, New York, working under the direction of a PMM partner in that office.

PMM assigned an SEC reviewing partner from the New York office to the Stirling Homex audit who participated in several meetings where significant decisions were made concerning unresolved audit questions. However, the SEC reviewing partner was unfamiliar with the income recognition policies of Stirling Homex and the government housing programs being utilized by customers of Stirling Homex. He did not review the audit workpapers and, in connection with the February 28, 1971 audit, met only once with the other PMM auditors for face-to-face discussion of the audit.

The Financial Statements of Stirling Homex Reported on by PMM

There is set forth below analyses of specific aspects of PMM's audit of the Consolidated Financial Statements for the seven month period ended February 28, 1971 and for the twelve month period ended July 31, 1971. In the view of the Commission, these analyses demonstrate that in a number of respects PMM's conduct of the audits was not in accordance with generally accepted auditing standards.

In a number of important areas, PMM unduly relied on the representations and interpretations of Stirling Homex management, and on management-prepared schedules and workpapers. It appears that this reliance was due in part to the inexperience of the PMM personnel and their unfamiliarity with government housing programs, government contracting or construction companies. Many such management representations were intentionally false and misleading and constituted part of a deliberate effort by management of the Company to deceive PMM, among others, as to the true status of a number of significant affairs. However, in the Commission's view, PMM accepted uncritically the representations of Stirling Homex with respect to these matters and did not take those steps which were required under the circumstances in order to verify the accuracy of the Company's assertions.

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[74] This method, as indicated above, differed from the method Stirling Homex utilized in connection with recording sales on the manufacture of the modules whereby Stirling Homex recorded sales and income upon the completion of the manufacture of the modules. See Accounting Research Bulletin No. 45.

* See Accounting Series Release No. 174 issued today by the Commission with respect to the activities of HKF.

[75] Although PMM reviewed HKF work papers, they did not learn of questions raised by HKF regarding the income recognition policies of Stirling Homex which HKF had reported on in the prior years' financial statements.

Thus, PMM's personnel relied on management's representation that a letter of designation represented a firm commitment of financing for a HUD turnkey project. As discussed above, letters of designation did not constitute a commitment of government financing and, should not have been relied on for that purpose by PMM. Documentation evidencing a legally binding commitment of governmental financing rarely existed prior to the reporting of income by Stirling Homex.

In several instances Stirling Homex obtained from the LHA contracts of sale on which the required HUD signature evidencing that funds had been authorized and reserved for the purchase of the development was missing. Absent such signature, there was no assurance that the project was eligible for financial assistance, that the funds had been properly authorized or that funds had been reserved by the government and were available to effect payment and performance by the purchaser LHA.[76] Despite the fact that these documents should have been recognized as being incomplete, PMM's personnel relied on the oral representations of Stirling Homex management that in practical effect financing had been committed to these projects. In the Commission's view this reliance was improper.

Similarly, PMM's personnel relied on the representations of management and an opinion of outside counsel expert in FHA matters furnished by management that letters of feasibility in practice represented financing commitments by the FHA. Although a feasibility letter was an important first step in obtaining FHA financing and indicated a strong interest in the project, feasibility letters in general, and the feasibility letters involved here in particular, were subject to specified conditions and, in the Commission's view, they did not represent a binding commitment of funds for the project for income recognition purposes.

The obtaining of a commitment of funding was an especially serious matter since the LHAs and other non-profit entities doing business with Stirling Homex were without financial resources and any agreements they entered into with Stirling Homex required financial backing of the Federal government. However, the auditors did not adequately familiarize themselves with the governmental housing programs despite their lack of prior experience with these programs and did not contact any Federal agency in order to verify the existence of commitments to finance the housing projects involved. The auditors' assumption that the LHAs would not enter into agreements with Stirling Homex without reasonable assurance of government financing was, in the Commission's view, unwarranted.

PMM's personnel relied on management-prepared schedules and workpapers, including computer runs of module assignment to projects, without adequate independent vertification of their accuracy. As it turned out such schedules were essentially meaningless unless a final site plan for the project existed. Such a site plan did not exist in many cases. They did not perform the extended audit steps which the Commission believes were called for with respect to the accounts receivable resulting from the improper and premature recording of module sales from periods preceding its engagement by Stirling Homex, carried on the books of Stirling Homex as unbilled accounts receivable.

In the Commission's opinion, the confirmation procedure used by PMM with respect to unbilled receivables was inadequate. The confirmations which were sent to the LHAs sought, for the most part only confirmation of the existence of a letter of designation or contract and the basic terms of the agreement, *i.e.*, the number of housing units and price. In the Commission's view, information, on the status of the project should also have been sought from the LHAs and, although it was perhaps reasonable to assume that an LHA would not confirm a project unless governmental funding was in fact available, the confirmations should have specifically requested confirmation of a funding commitment.

The Commission also believes that the handling of the confirmations by the audit staff was faulty in that they failed to take extended audit steps to evaluate the significance of remarks written on certain of the confirmations or deviations from normal confirmation practices, such as, in one case, the return of a confirmation to the company rather than to the auditors.

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[76] In some cases, Stirling Homex did not actually have a letter of designation but only a preliminary, non-binding letter of intent.

February 28, 1971 Audit

Listed below is a schedule of projects for which Stirling Homex, in the Commission's view, improperly recorded sales during the seven months ended February 28, 1971.

	Module Sales	Percent Total Sales
Portland Project	$ 569,200	4.5
Rochester	1,200,400	9.5
Ithaca	721,600	5.7
Washington, D. C.	678,400	5.4
Mississippi GGC	7,916,000	62.8
Additional sales recognized on projects previously recorded in the 1970 fiscal year	1,522,400	12.1
	$12,608,000	100.0

(a) *Mississippi GGC Project*

This project accounted for 62.8% of the module revenue reported for the seven month period ended February 28, 1971 and represented over 44% of the total revenue reported for the period.

In December, 1970, Stirling Homex entered into a contract (subsequently amended) with the Mississippi Greater Gulf Coast Housing Development Corp. ("GGC"),[77] a non-profit corporation with no financial substance, for the construction of 800 modular units for $15,000,000 with the funding to by provided by the Farmers Home Administration, an agency of the Department of Agriculture ("Farmers Home").

As evidence of the financing commitment necessary for the inclusion of sales and earnings from this project in the financial statements, PMM's personnel relied on a letter to GGC from Farmers Home dated February 22, 1971 which purported to represent a commitment of government financing for $15 million.[78] This letter was a forged or spurious document on the stationery of Farmers Home.[79] GGC had neither a history of operations, nor any financial substance. Since there was no funding for the project, it should not have been included in sales.

The contract with GGC was subject to agreement on acceptable sites for the projects conditioned upon the approval of the appropriate governmental funding agency and the obtaining of financing from the appropriate governmental funding agency. No site plans or proposed site plans existed. No modules were ever shipped to Mississippi for this project, and the project was never built.

Because of the magnitude and effect on the Stirling Homex financial statements of the sales and earnings of this project, it should have been audited with greater care than PMM exercised.[80] PMM's personnel, without knowing even the general guidelines of the Farmers Home program, accepted their reading of the February 22, 1971 letter and the oral representations of Stirling Homex management at a meeting described below as a sufficient basis to conclude that there was a firm commitment of financing for this project.

On March 19, 1971, three PMM auditors, including the client partner and the SEC reviewing partner, visited the offices of Stirling Homex to discuss with Stirling Homex management problem areas of the audit then being conducted. Among the areas discussed was the absence of evidence of such financing.[81]

At this meeting the management of the Company submitted the $15 million commitment letter for the inspection of the PMM auditors. These auditors requested a copy of the letter for their files, but the

[77] Although PMM was not aware of this fact, this group was formed at the behest of Stirling Homex solely because of the necessity to have such a corporate vehicle to ostensibly negotiate and contract with Federal agencies for the funding of housing projects.

[78] The limit of funding on any individual Farmers Home project is restricted by statute to $750,000. The Mississippi GGC contract provided that Mississippi GGC had the rights to assign its rights under the contract to one or more nonprofit corporations subject to the approvals of the appropriate governmental funding agency involved.

[79] PMM did not know that the document was forged or spurious and it was presented to PMM as representing a commitment of funding by Farmers Home.

[80] The confirmation received by the auditors as of February 28, 1971 in connection with GGC confirmed "a contract dated February 28, 1971 providing for total development and construction cost of fifteen million dollars," whereas in fact the contract for which confirmation was being sought was dated December 28, 1970. Although this was treated as a clerical error (and the July 31, 1971 confirmation subsequently received referred to the appropriate contract date) and we do not suggest that this contract was not in fact validly executed, we nevertheless believe that under the circumstances further inquiry should have been made concerning the date of the contract.

[81] PMM's workpapers contain a notation by a PMM partner stating that absent such financing "the income recognition on the sale of the financed modules could be jeopardized."

management of the Company stated they could not provide one at that time, stating that there were "political reasons" for keeping the letter confidential until local announcements were made by the sponsor of the project. No copy of the letter was subsequently obtained, nor did the auditors make an abstract of its terms or attempt to verify the authenticity of the document through direct communication with the Farmers Home. There was no other documentary support in PMM's work papers demonstrating a firm commitment of financing necessary to justify recording the Mississippi GGC project in sales.

Under the GGC contract the non-profit group was responsible for obtaining 100% financing provision was later modified and financing provisions was later modified and U. S. Shelter ("USS"), a wholly owned subsidiary of Stirling Homex, was to arrange financing and receive a 2% financing fee ($300,000) upon acceptance of this provision by the GGC.

The financing fee of $300,000 was reflected in the Consolidated Statement of Income contained in Stirling's Homex's 1971 registration statement. The footnotes to the financial statements disclose that this fee was earned under an agreement with a non-affiliated customer whereby USS had rendered certain services to the customer which included the obtaining of a commitment from a Federal agency for permanent financing of a housing project. This income was improperly recognized. This footnote is false and misleading in that although this agreement, as shown to PMM, was dated February 15, 1971, it was in fact signed in March—after the balance sheet date—and thus the non-affiliated customer had not retained USS's services as of the balance sheet date and as indicated above, USS had not obtained any commitment of permanent financing from a Federal agency nor rendered any other services to this customer.

Although PMM mailed a confirmation to GGC concerning this USS financing fee, the confirmation was not returned. PMM did receive, however, a letter from the GGC, but that such fee was subject to cerposed financing commitment to GGC on February 15, 1971 had been accepted by GGC but that such fee was subject to certain terms and conditions of the agreement dated February 15, 1971 and that payment of the fee was to be deferred until the date of any loan closings. The letter did not state when the proposed financing agreement had been accepted by GGC.

The auditors had a copy of the February 15, 1971 agreement in their workpapers. They questioned the recognition of income by USS of this fee since there was no indication that USS had obtained any commitment for financing. To provide evidential matter to support this financing fee, PMM obtained from Stirling Homex a copy of an ambiguous letter from Stirling Homex's bank which, stated that the bank had approved an unsecured $15 million line of credit, but also stated that borrowing under the line was to be limited to $3 million outstanding at any one time. Despite the obvious ambiguity in the letter, the auditors did not confirm the commitment's existence or its terms with the bank.

(b) *Rochester, New York Project*

In late 1970, Stirling Homex submitted a proposal to the Rochester Housing Authority ("RHA") to develop a turnkey project of 91 units on four scattered sites for approximately $2.3 million. No contract or agreement was executed for this project. Stirling Homex recorded $1.2 million in modular sales on this project on the basis of a letter of designation from the RHA dated February 26, 1971. These sales constituted a material portion of total sales for the seven month period.

PMM sent a letter to the RHA requesting confirmation that RHA had accepted Stirling Homex's proposal for the 91 units. The letter was returned to PMM marked correct with an attached copy of the letter of designation for 91 units that the RHA had sent to the Company.

The designation letter, while tentatively designating Stirling Homex as developer of the project, set forth a schedule of events and approvals including site approval by various authorities, negotiation of the ultimate price that would have to be effectuated prior to the execution of a firm contract of sale, and a commitment of Federal assistance in financing the purchase of the projects by the RHA. PMM also obtained from Stirling Homex a copy of a letter dated February 26, 1971 to the RHA from the Area Director of HUD which authorized the RHA to designate Stirling Homex as the turnkey developer of the project, subject to the RHA's letter of designation containing the phrase "subject to site approval by the City of Rochester."

The auditors established no procedures to monitor the accomplishment of the events outlined in the designation letter. The various problems of rezoning, adequate sewage systems, and local governmental approvals were never resolved. The proposed Rochester sites were found unacceptable by HUD and the project was never constructed.

There was no legally binding contract in effect between the RHA and HUD or other evidence of financial commitment for this project. Therefore, sales and income in this project should not have been recognized.

(c) *Washington, D.C. Project*

A proposal was made to the National Capital Housing Authority ("NCHA") in the fall of 1970, to develop this turnkey project which would consist of 51 dwelling units for a proposed purchase price of $1,217,640. No contract was obtained by Stirling Homex on this project at any time. For the seven month period ended February 28, 1971 Stirling Homex recorded modular sales of $678,400 for the project.

PMM workpapers contain only three documents to support recognition of $678,400 of module revenues on this project. One document was a copy of an undated letter proposing two possible housing developments to the NCHA. Another was a letter dated February 26, 1971 from the NCHA to Stirling Homex informing the Company that it had been selected as the turnkey developer for a particular site and additionally informing the Company that approval by the community as well as by the Board of Directors of the District of Columbia Redevelopment Land Agency ("RLA") was required for the development.

The third letter from the RLA, also dated February 26, 1971, indicated that the RLA approved the selection of Stirling Homex as the developer of the site but that final approval could only be given after public hearings before the RLA's Board of Directors. No audit procedures were undertaken by the staff of PMM to determine whether the required approval was ever obtained for this development.

A letter, dated March 12, 1971, was sent to the NCHA by PMM requesting that they confirm the acceptance of the Company's proposal for a 51 dwelling unit housing development. This letter was returned to PMM signed by an official of the NCHA indicating the information was essentially correct. A typewritten note on the returned NCHA confirmation informed PMM that: "Before the proposal is finalized the Authority, RLA and the HUD Regional Office must review and approve construction and financial details."[62]

The Commission believes that, in the circumstances, there did not exist evidence of a commitment by NCHA to purchase the housing units, or a commitment by HUD to finance the project and this income should not have been recognized.

(d) *Portland, Maine Project*

At the time of income recognition, there was no firm commitment of funding for this project although a subsequent commitment was later obtained in July of 1971 and the project was completed. PMM received from Stirling Homex a copy of a turnkey agreement dated January 28, 1971 entered into by Stirling Homex and the Portland Housing Authority ("PHA") for the sale of a 50 dwelling unit housing development for $1,280,662. Stirling Homex included in sales $569,200 from this project. There was no funding for this project identified in the space provided in the contract. Further, the agreement was not signed by HUD. Consequently, there was no evidence of a legally binding commitment of federal monies to fund the purchase of the project at the time of the completion of the audit field work.

As late as June 25, 1971 Stirling Homex, PHA and HUD were still negotiating over price and specifications for the project, and it was not until July 22, 1971 that a firm contract was executed by the PHA, HUD and Stirling Homex.

(e) *Ithaca, New York Project*

PMM obtained from the Company as evidence that a contract of sale existed a document dated March 3, 1971 by which the Ithaca Housing Authority ("IHA") contracted to purchase from Stirling Homex a completed housing development consisting of 54 dwelling units for $1,233,050. Although the development was to be purchased and funded under the turnkey program of HUD, no turnkey contract in the required HUD form was executed. There was no formal commitment of Federal

[62] In connection with the July 1971 audit, the confirmation return did not contain any such typewritten note.

funding as of the February 28, 1971 period although a formal commitment was subsequently obtained and the project was completed. Sales of $721,600 from this project were included—improperly in the Commission's view—for the February 28, 1971 period.

(f) *Accounts Receivable at February 28, 1971*

In addition to the newly recognized sales during the period under audit, Stirling Homex carried a substantial amount of accounts receivable and cost overruns on projects recorded as sales during the 1970 fiscal year, which were also audited by PMM during its audit of the seven-month period. Listed below are some of the projects and the amounts of the accounts receivable which the Commission believes were improperly recorded as of February 28, 1971:

Project	*Accounts Receivable*
Hillwood, Akron	$4,470,000[83]
Highland, Akron	3,352,020
Bridgeport Street, Worcester	329,500
Providence Road, Worcester	416,100
Bird and Pearl, Erie	1,283,000
Pittsburgh, Erie	444,400
Grandview, Erie	1,174,600
North St. - Worcester	469,000

All the above accounts receivable recorded on Stirling Homex's financial statements as of February 28, 1971 were recorded, although in several instances in substantially smaller amounts, during the 1970 fiscal year of Stirling Homex ended July 31, 1970. The delays in payments and progress on these projects had continued as of February 28, 1971 and should have prompted extended audit procedures.

With certain exceptions, these projects were in essentially the same posture as they were in the prior fiscal year in that there had been little installation work accomplished, no money collected and no formal commitment of funds by any government agency.[84] The terms of some of the agreements themselves, had expired, such as the 120 day completion clause. All of these projects were HUD turnkey projects. The supporting agreements were not executed by HUD and therefore not backed by a funding commitment.

During the audit, PMM's personnel learned that the proposed site for the Bridgeport project had to be abandoned. They received the following statement on a returned confirmation from the Worcester Housing Authority that referred to Stirling Homex's dealings with them on the Bridgeport project:

> "In July 1970 this Authority and Kabeth Properties, Inc. were in the process of negotiating a contract for the purchase of 25 units to be erected on Bridgeport Street in Worcester, Massachusetts for the sum of approximately $563,350.00. Because of problems involving site location, the proposed site had to be abandoned. At the present time, the Authority is awaiting submission by Kabath Properties, Inc. of a set of contract documents for approximately the same number of units on a suitable site in Worcester, Massachusetts.

July 31, 1971 Audit

Listed below is a schedule of projects for which the Commission believes Stirling Homex improperly recorded sales during the fiscal year ended July 31, 1971:

	Module Sales	*Percent Total Sales*
Rochester	$1,200,400	4.1
Washington, D. C.	678,400	2.3
Mississippi GGC	8,520,400	28.9
St. Thomas, V. I.	1,360,000	4.6
St. Croix, V. I.	1,360,000	4.6
Clay	1,951,000	6.6
Morgantown	2,418,000	8.2
Stanley Simon	6,282,500	21.3
Grandview	317,600	1.1
Hillwood	86,800	0.3
Highland	1,118,000	3.8
	$25,292,600	85.8
Total Sales	$29,482,271	

(a) *Virgin Islands Project*

The documentation in PMM's workpapers for the two projects was identical and the contracting entity was the same, Quantum Development Corporation ("Quantum"), a non-profit corporation sponsoring the

[83] Stirling Homex recorded accounts receivable of $6,818,000 during this period on this project against which $2,348,000 was purportedly received by the Company, leaving a net receivable of $4,470,000. In fact the $2,348,000 which related to three other Akron projects was erroneously applied to this receivable and the figure should have been $6,818,000.

[84] The Providence Road, Bird & Pearl Street and North Street projects representing approximately $2,170,000 out of a total account receivable figure at February 28, 1971 of $26,960,000 were paid for prior to July 31, 1971. However, cost overruns on the projects accumulated in excess of $326,000 upon completion.

housing development pursuant to the FHA's Section 236 program.

The earliest dated contracts were purchase agreements executed September 22, 1970. The terms of the purchase agreements called for the sale of 200 dwelling units for a total purchase price of $2,720,000 for each of the locations. Stirling Homex was to pay for the shipment of the modules to their respective locations and only to supervise their installation.

PMM's workpapers also contained a feasibility letter dated January 8, 1971 addressed to the Virgin Islands Foundation for Housing and Economic Development ("VIFHED") St. Croix, Virgin Islands. This letter had an expiration date of 30 days and had not been renewed. PMM's personnel did not know of any relationship between the VIFHED and Quantum, nor did they do any follow-up procedures to determine whether the feasibility letter had been renewed.

A second agreement between Quantum and Stirling Homex, dated June 1, 1971, was also in PMM's work papers. This purchase agreement called for the purchase by Quantum of 100 dwelling units for a price of $1,360,000 for each of the two sites or a total of $2,720,000 for 200 dwelling units. According to the terms of this contract, payment was to be in the form of an irrevocable letter of credit to be issued by the First Pennsylvania Trust Company of Philadelphia. Other conditions set forth in the agreement were:

(1) Approval of the modules by the FHA;

(2) Payment was to be made on the issuance of an appropriate bill of lading; and

(3) The modules were to be constructed in accordance with the plans and specifications.

The workpapers of PMM indicate that reliance for the commitment to fund the project was placed on the expired feasibility letter and on oral representations by the Company that a bank letter of credit had been furnished to Stirling Homex. In fact, a letter of credit had not been obtained by Stirling Homex at the time of PMM's audit and neither this letter of credit nor other financing was subsequently obtained.

On July 31, 1971, PMM sent a confirmation to Quantum to confirm information concerning its contract with Stirling Homex dated September 22, 1970 of 400 dwelling units for $5,400,000 with the terms of payment 10% of the units upon approval and acceptance of plans and specifications by mortgage and the balance upon acceptance of modules at the factory. The confirmation was returned marked incorrect and there was a letter attached which said there was a new contract dated June 1, 1971 for 200 dwelling units at $2,720,000. In addition, the letter indicated that 10% of the contract price was to be paid upon approval and acceptance of the plans by the mortgagee and the balance upon acceptance of the modules at Stirling Homex's plant.

Moreover, in a note to its workpapers in the July, 1971 audit, PMM indicated the following as to this project: "FHA financing being processed by the LHA there so Stirling does not keep upon their progress. Stirling and PMM are relying on the bank letter of credit for the credibility of financing monies."

(b) *Clay, New York Project*

This project involved an application with FHA under a Section 236 program of 150 dwelling units for a total price of approximately $3.5 million. Tht applicant on the project for which Stirling Homex was to be the builder was Clay Development Corp. ("Clay"), a wholly-owned Stirling Homex subsidiary. Clay, in turn, had an agreement with a non-profit sponsor under which the project would be purchased by the sponsor upon completion. In the closing days of the 1971 fiscal year, Stirling Homex recorded about $2 million of modular sales on this project

Sales were recognized on the basis of a feasibility letter dated July 30, 1971 from the FHA. The letter by its terms specified that its issuance was subject to receipt of an allocation of Federal funds. Further, the letter indicated that prior to the commencement of subsequent processing a municipal tax abatement for the project would be required. Thus, the letter did not evidence a firm commitment of financing. Had they extended their audit procedures, the auditors could have discovered that no commitment of federal funds had been made.

Additionally the purported arrangement between Clay and the non-profit sponsor for the resale of the project was a sham.[85]

[85] The non-profit sponsor for the project in fact had withdrawn at the time of the July 1971 audit. PMM was not aware of this fact.

Therefore the purported sale was only to Clay, a wholly-owned subsidiary of Stirling Homex. As such, it should have been reflected in the financial statements as a sales to an affiliated company.

(c) *Morgantown, West Virginia Project*

This project involved an application with FHA under Section 236 for 200 units for a total price of approximately $4.3 million. During the fourth quarter of the 1971 fiscal year ended July 31, 1971, Stirling Homex recorded approximately $2.5 million of modular sales on this project, using as a basis for evidence of firm commitment of financing on the project a letter dated July 30, 1971 from the FHA to Aquarius Development Corp. ("Aquarius"), a wholly-owned subsidiary of Stirling Homex. The project was the result of a contract between Aquarius and a non-profit entity.

The letter, while cast in the form of a feasibility letter, was in fact meerly an offer to Aquarius to submit a revised application for a feasibility letter. It was not a firm commitment of financing and the Commission believes should not have been relied on as evidence of such a commitment. The modules that were supposedly manufactured for this project were structurally unsuitable because they were over two feet short of the required length. This proposed project was later abandoned for this reason and because of inability to obtain financing.

Moreover, as in the case of the Clay project, the purported agreement to sell the project to a non-profit sponsor was a sham.

(d) *Stanley Simon Project*

In the 1971 fiscal year ended July 31, 1971 modular manufacturing sales of nearly $6.3 million were recorded on this project on the basis of an agreement dated April 23, 1971 between Stirling Homex and Stanley Simon and Associates ("Simon") acting on its behalf and behalfs of limited partnerships to be formed in the future. The agreement provided for the purchase of 1,000 modules at $11,000 per module for a total price of $11,000,000. It called for a $25,000 down payment on each site with the projects to be financed conventionally rather than through government programs. Each site for the modules was to be approved by both parties. For the most part, there was no commitment of financing on the project and there was no assurance that Simon would be able to arrange such financing.[66] In early July, 1971 Stanley Simon and Stirling Homex began drafting a contract to cover the 1,000 module units pursuant to the terms set forth in the April 23rd letter of understanding but this contract was never finalized.

During the July 31, 1971 audit, PMM's personnel realized that a firm commitment of financing was unavailable inasmuch as they specifically noted in their workpapers that financing for this project was "pending." The review notes compiled by the PMM audit manager indicate that as late as September 23, 1971, subsequent to the date of PMM's report, PMM should "obtain proof of 100% permanent financing."

A PMM partner was aware that financing was not committed for the sales recorded on the Simon project by the close of the 1971 fiscal year and not obtained during the audit period. He was not concerned with the absence of any firm commitment because he relied on the reputation of Simon personally and the fact that Simon was known to be a man of considerable wealth. The partner felt that this was sufficient reason to permit income recognition on the project.

(e) *Stirling Homex Accounts Receivable as of July 31, 1971*

Receivables associated with revenues recorded in fiscal 1970 on many of the projects discussed above were still carried as receivables at the end of fiscal 1971.[67] There is evidence in the PMM workpapers that there were substantial problems with respect to many of these projects. The Commission believes that PMM failed to take cance of these problems, relying on optiadequate audit steps to assess the signifimistic representations of Stirling Homex management which were received in response to the auditors' inquiries.

Listed below are several examples:

(1) *Pittsburgh Project Receivable of $444,000.* PMM was informed by Stirling Homex

[66] The only evidence that was submitted to PMM that any permanent financing had been obtained, was a commitment dated July 19, 1971 by the Dime Savings Bank of Williamsburg ("DSBW") to make a first mortgage loan in the amount of $825,000 for a 112 unit development to be constructed in Utica, New York. The commitment by the DSBW was short in the amount of $283,000 required to make up the full sale price ($1,232,000). As for the remaining module sales reported as attributable to the Simon contract, no revenues should have been recognized because of the lack of evidence of permanent financing.

[67] Approximately $36,400,000 of accounts receivable out of $37,850,000 total accounts receivable were improperly included as assets.

that HUD had expressed reservations about the project site and Stirling Homex had indicated it could substitute another site if necessary. There is no indication that PMM examined any correspondence or other documentary support for this statement by management.

(2) *Washington Project Receivable of $678,400.* PMM was informed during the 1971 fiscal year audit of the substantial delays being experienced with respect to this project because of the necessity of obtaining numerous approvals.

(3) *Grandview, Erie Project Receivable of $1,269,600.* During the 1971 fiscal year this project was substituted for the 37th and Tuttle Street Project in Erie, Pennsylvania, on which sales were recorded during Stirlig Homex's 1970 fiscal year pursuant to an agreement with the LHA. As noted in their workpapers, the auditors were aware of the "political and community entanglements" being experienced by Stirling Homex.

(4) *Bridgeport Project Receivable of $329,-500.* PMM knew that this receivable was troublesome because no new replacement site had been located for the previously abandoned site and any replacement site was subject to HUD's approval.

(5) *Mississippi GGC Receivable of $8,520,-400.* PMM learned during the 1971 fiscal year audit that Stirling Homex was making application and seeking approval for several sites through the Farmers Home. PMM learned that a $750,000 "prototype" project proposal for 50 out of the 800 units had not received final approval by the time the audit was being performed.[68] Moreover, the modules had not been shipped to Mississippi.

(6) *Hillwood Project Receivable of $7,-240,000.* This project, which had been carried as a receivable by Stirling Homex since October of 1969, had almost no site work accomplished and was encountering zoning problems. Stirling Homex had reduced the number of modules for this project. Despite the size and age of this proposed project PMM took no extended audit steps with respect thereto.

(7) *Highland Project Receivable of $3,-352,000.* At the close of the 1971 fiscal year of Stirling Homex, there had been no progress on this project even though it was a large receivable and had been recorded in the 1970 fiscal year of Stirling Homex. The project site had been switched from the Highland Street, Akron location to a completely different site in East Barberton, Ohio. The sales that had supposedly represented the Highland project were not reversed on this project but merely switched to the Barberton Project. However, in October of 1971, Stirling Homex entered into an entirely new contract of sale which was approved by HUD and the project was ultimately completed and paid for.

Cost Overruns on Stirling Homex Projects

By the close of its 1971 fiscal year, Stirling Homex had incurred over $1 million of cost overruns on various projects, which were carried on its books as receivables. Further, Stirling Homex carried an additional $1,000,000 of cost overruns as Contracts in Progress.[69] These cost overruns represented additional costs incurred by Stirling Homex in excess of that portion of the contract price allocated to installation sales, which additional costs had not been and were not reimbursable under the terms of the applicable contracts. The existence of these cost overruns was not properly accounted for in Stirling Homex's financial statements nor disclosed in the accompanying footnotes.

Despite the unusual nature and size of these cost overruns PMM did not undertake adequate audit steps in that it failed to obtain reliable support for their collectibility.

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[68] In fact, by the time of the PMM audit, the project had been rejected by the Farmers Home. This was not known to PMM.

[69] Stirling Homex improperly classified as an asset certain costs and expenses amounting to approximately $832,000 for the seven months ended February 28, 1971 and $1 million for the fiscal year ended July 31, 1971 which related to the construction of a proposed Mississippi plant to be financed by a $5 million industrial bond offering. This classification permitted these amounts to be capitalized rather than expensed during the period in which they were incurred, and resulted in an overstatement of net income for said periods. PMM's acceptance of this classification was inappropriate in that reimbursement was unlikely under the terms of the trust indenture, a substantial portion of the expenses were general and administrative expenses, and the reimbursement of the $1 million in intangible expenses from the offering proceeds was highly unlikely since they represented 20% of the total proceeds. Stirling Homex incurred these cost overruns because of delays caused by Stirling Homex's premature manufacture of modules, which were in large part motivated by the Company's income recognition policies. These delays caused increased expense such as storage costs, module refurbishment, and dissatisfaction with the Stirling Homex product by some customers.

Subsequent Discovery of Improper Business Activities

After being shown Stirling Homex's Form 10-Q for the period ended October 30, 1971, PMM personnel learned that the $2,720,000 in modular sales for the Thomasville and St. Croix projects had been reversed, that the modules had been reassigned to another project and that these facts were not publicly known. The Company advised PMM that this was an unusual nonrecurring transaction occasioned by events which took place after July 31, 1971.

Even though PMM personnel knew of these reversals and their possible effect on the audited financial statement for the July 31, 1971 period, they failed to follow auditing procedures that should be complied with in such circumstances to determine whether these reversals required modification or withdrawal of PMM's report on the July 31, 1971 financial statements.[90]

During March of 1972, PMM objected to the Company's recognition of a very large amount of income on two newly begun projects involving private financing. As a consequence, income from these projects was not reflected in Stirling Homex's financial statements for the period and the Company reported a substantial loss from operations for the quarter.[91]

In May of 1972, PMM auditors were told by management that Stirling Homex's financial condition was deteriorating rapidly and that it would report a $20 million loss for the nine months ended April 30, 1972, including substantial charges against income for the period resulting from a reduction in the sales price of modules on certain projects upon which revenue had been recognized in prior fiscal periods, a provision for the repair and refurbishing of 10,000 uninstalled modules in storage areas of the company, a provision for estimated additional costs of construction on the Stanley Simon project, a provision for doubtful accounts with respect to the cost overruns which were included in accounts receivable and a provision for various overrun costs incurred in connection with the construction of several projects.

The auditors were completely "dumbstruck" by this recital by Stirling Homex management. They failed to undertake any review or investigation to ascertain whether the newly discovered facts existed at the date of their report on Stirling Homex's financial statements. Due to the nature of these extraordinary charges, it should have been clear to them that the previous financial statements of Stirling Homex were seriously deficient.

Statements to the Commission Staff

On July 7, 1971 a meeting was held at the Commission in connection with the then pending registration statement of Stirling Homex to discuss the Division of Corporation Finance's letter of comments. Present at this meeting were representatives of Stirling Homex, its outside counsel, underwriters and partners of PMM.

The meeting began with a general discussion concerning the staff's letter of comments.[92] Then a more particularized discussion took place concerning Stirling Homex's income recognition policies, with the client partner of PMM asking whether the staff of the Commission desired Stirling Homex to recognize on the completed contract method. He questioned this method and stated that under the circumstances this method would not be in accord with generally accepted accounting principles.

The PMM partner stated that the real question was not a matter of mechanical application of accounting theory but rather at what point in time sales should be recognized and what event should have transpired prior to recognition. He then outlined four events that had occurred prior to recognition of income by Stirling Homex, which in effect, would remove any credit risk. The most important of these events that he outlined was that there was a commitment of permanent financing to purchase the project.

[90] See Statement on Auditing Standards 1 at Section 561.01 ff. ("Subsequent Discovery of Facts Existing at the Date of the Auditor's Report").

[91] This announcement started the chain of events which led to the ultimate bankruptcy of the Company in July 1972.

[92] One of the matters under discussion was a certain land sale. PMM originally advised Stirling Homex that the transaction as originally structured would not, in its opinion, qualify for income recognition but indicated that if the transaction were restructured to bring it within the real estate guidelines then being applied generally by PMM, income would properly be recorded. The transaction was then restructured along the lines advised by PMM, and PMM gave its opinion to Stirling Homex management that income could be recognized. During the meeting the Commission's Division of Corporation Finance indicated its disagreement with PMM's views and the sale was reversed.

A number of statements by the partner were largely inaccurate. Very few of Stirling Homex's projects were covered by permanent financing. Had he made appropriate verification during the earlier audit period or prior to the Commission meeting, he would have known that these statements were not true.

The oral statements of the partner were subsequently confirmed in the supplemental submission submitted by Stirling Homex in July 1971. The purpose of this submission was to outline Stirling Homex income recognition policies for the staff of the Commisison in an attempt to dissuade the staff from insisting on the completed contract method of income recognition.[93]

It contained numerous false statements, including misrepresentations concerning the turnkey and other government programs as utilized by Stirling Homex and the fact that Stirling Homex had fulfilled certain conditions precedent before including its projects in sales.

CONCLUSIONS

As illustrated above, the Commission believes that PMM failed in a number of material respects to conduct the February 28, 1971 and July 31, 1971 audit engagements in accordance with generally accepted auditing standards.

Valuable lessons can be derived from PMM's conduct, which, if focused upon, will hopefully prevent similar occurrences in the future. The facts of this case suggest that for a new and unknown client, some independent investigation should be made of the company, its customers and methods of doing business. When a client extensively utilizes government programs and contracts, it is expected that the auditors will have a thorough and complete familiarity with the programs.

In addition, care should be given to the organization of the "audit team" so that responsibilities are clearly defined. With respect to the Stirling Homex audit, the presence of two partners operating out of different offices supervising the same audit work gave rise to a situation where important decisions were deferred and the division of responsibility was not clear. As a result, it was difficult to coordinate effective control over the audit and the decision making process with respect thereto. This situation permitted vacillation on major decisions which ultimately were never satisfactorily resolved by either partner.

During the audit of Stirling Homex, the SEC review by PMM's SEC reviewing partner was superficial although the audit was one where it had been determined that an "in depth" review was required.

A successor auditing firm should review the working papers of the predecessor auditors. Such review should cover critical audit areas and unusual accounting matters. It should also cover disagreements between the predecessor auditors and management, whether or not they are satisfactorily resolved, which relate to accounting principles, auditing procedures, and the predecessor's understanding regarding the reasons for the change of auditors. Further, successor auditors should always be alert to factors bearing on the integrity of management.

A major deficiency of the Stirling Homex audit was PMM's reliance on the unsupported, undocumented representations of management. An auditor should not rely solely on the representations of management, but satisfy themselves as to such matters by other means consistent with the circumstances of the particular transaction, such as independent documentary verification.

Auditors should be wary when sales and income are sought to be recognized on the basis of assumptions and projections as to future events necessary for the ultimate realization of such income. In this case, sales and income were recognized on government financial housing projects at an early stage in the processing of the projects and at a point where the essential commitment of government financing was not in existence and where the projects were still subject to a variety of conditions such as the politically explosive issue of site selection of low income housing. The auditors, in part because of their unfamiliarity with government housing programs, accepted optimistic and in some cases deceitful representations of the company and others regarding the programs and projects in question. The Commission believes that in cases such as these where income recognition occurs well before the point at which the customer is normally billed, auditors should exercise a high degree of caution and skepticism.

[93] These elements are substantially the same elements discussed in connection with Stirling Homex's accounting methods. See discussion above.

Also we believe that auditors have a duty to disclose subsequently acquired information which existed at the date of the auditor's report and establishes that previously reported upon financial statements are materially false and misleading. On two occasions during the 1972 Stirling Homex fiscal year, PMM learned information, which if PMM had investigated as they should have, would have disclosed to PMM that earlier prepared financial statements of Stirling Homex were materially false.

Finally, it must be noted that the statements made by the PMM partner to the Commission staff in connection with discussions of the Stirling Homex registration statement constitute unacceptable professional behavior in practice before the Commission. Independent professional accountants should not act as advocates on behalf of their clients before the Commission, especially when the accountant is making factual statements about a particular client's business which have not been verified. As the Commission recently stated:

> "The Commission and its staff do not and cannot investigate representations made to it, but must be able to rely on their completeness if this process is to work. The objectives of the securities laws can only be achieved when those professionals who practice before the Commission, both lawyers and accountants, act in a manner consistent with their responsibilities. Professionals involved in the disclosure process are in a very real sense the representatives of the investing public served by the Commission, and, as a result their dealings with the Commission and its staff must be permeated with candor and full disclosure. It cannot resemble an adversary relationship more appropriate to litigants in court, because the Commission is not an adverse party in this context. All who are familiar with the Commission's policies know that too much importance is attached to the word of the professional, to permit his of her word to become the subject of question. A professional's word is often the functional equivalent of his or her reputation. Conferences with the staff of the Commission serve a vital role in the administration of the securities laws, and such conferences are predicated, for the most part, upon full disclosure by the professionals involved. It must be understood by all who practice before the Commission, lawyers and accountants alike, that the Commisison and its staff cannot tolerate less than full disclosure."[94]

* * *

CONCLUSION

As contemplated by PMM's offer of settlement, PMM has agreed to an investigation into the manner in which it conducts its audit practice with respect to clients whose financial statements, reported upon by PMM are filed with the Commission. That comprehensive examination is to be carried out by a committee whose compensation and expenses will be borne by PMM. Members of the committee will be agreed upon by PMM and the staff of the Commission. The nature and scope of the examination is outlined in a memorandum addressed to the committee which has been agreed upon by the Commission and PMM and which is annexed to the offer of settlement. It is contemplated that the examination can be completed and the report of the committee submitted to the Commission within approximately six months. PMM also has agreed to the entry of an order by the Commission requiring it to adopt and implement any reasonable recommendations the committee may make with respect to PMM's SEC audit practice and procedures.[95] The offer of settlement also contemplates that two annual reviews of PMM's audit practice, will be conducted in 1976 and 1977 at firm expense, and the results of these reviews will be reported to the Commision and PMM.[96]

PMM has agreed to the entry of an order by the Commission prohibiting it from accepting audit engagements for new SEC clients for the six-month period beginning on May 1, 1975 and terminating on October 31, 1975. During that period, with certain exceptions, PMM will not accept or negotiate for the acceptance of new SEC

[94] See *In the Matter of Arthur Andersen*, ASR #157, Exchange Act Release #10906.

[95] In the event that PMM demonstrates to the satisfaction of the Commission that a recommendation of the committee is not reasonable or need not be implemented either in the form recommended or with reasonable modifications, then it has been agreed that such recommendation need not be adopted.

[96] Since it is contemplated by all concerned that this examination and two subsequent reviews are designed to serve the purposes embodied within Rule 407 of the Federal Rules of Evidence, the parties have agreed to an order which the court has entered requiring that the details of the examination and reviews, the working papers and other documentation other than the reports of the committee and the reviewers and the deliberations of the committee and reviewers are to be held confidential.

clients.[97] This six-month restriction does not affect in any way PMM's ability to service its existing clients nor does it affect other aspects of PMM's practice such as tax and management consulting.

PMM has also agreed to the entry of final judgments of permanent injunction in each of the four injunctive actions the Commision has instituted against the firm. These injunctions, among other things, prohibit the firm from engaging in specified violations of the federal securities laws with respect to the financial statements of the companies that gave rise to these proceedings. One of the injunctions formalizes certain PMM procedures and requires that they be followed with respect to accepting new audit clients generally and special procedures when a new engagement follows a resignation by a predecessor auditor which has resulted in the filing of a Form 8-K with the Commission reflecting identified professional disagreements between the predecessor auditor and the client.

Further, PMM has agreed to revise and implement certain procedures with respect to (i) its existing pre-issuance review of reports by a second partner not otherwise associated with the engagement in that the second partner will evaluate the appropriateness of financial statement disclosures and the accountants' report relating to material discussed in the engagement partner's memorandum that memorandum, which will be prepared following a review of the working papers, and will identify and discuss the critical audit areas and unusual accounting matters encountered during the course of the audit; (ii) its existing review by a second partner of specified types of engagements which will include an in depth review of the appropriateness of judgements and the working papers in the critical audit areas and unusual accounting matters, and (iii) ascertaining that engagement partners or, if necessary, others associated with them are adequately informed with respect to any unusual or abnormal practices peculiar to the industry and circumstances involved in the engagement. PMM has also agreed to conduct a study of the use of the percentage of completion method of accounting and to establish guidelines in this area for its audit practice, which guidelines are to be applied in the conduct of its audits for fiscal years beginning on or after December 27, 1975. The procedures and the study and the implementation thereof, including the guidelines, are the subject of this order as set forth below.

In determining to accept PMM's settlement offer, we have taken into account the fact that these controversies relate to audit engagements for five clients out of a large number of audit engagements conducted by PMM over the years in question going back to 1968, and that, based upon information submitted by PMM and otherwise known to us, their overall audit practice appears to be conducted in a competent and professional manner. Moreover, we believe that the provisions of the settlement offer will provide PMM and the Commission with independent assurance of the quality of PMM's audit practice before the Commission. While the Commission continues to retain jurisdiction over this proceeding, this settlement resolves these existing disputes between PMM and the Commission.

For the foregoing reasons, it is hereby ORDERED,

1. This proceeding under Rule 2(e) of the Commision's Rules of Practice is instituted. PMM's offer of settlement, dated June 5, 1975, is hereby accepted.

2. An investigation will be made of the manner in which the audit practice of PMM is conducted with respect to audit clients whose financial statements reported upon by PMM are filed with the Commission.

a. That examination will be carried out by a committee (the "Committee") whose

[97] For the six-month period from May 1, 1975 through October 31, 1975, PMM has not accepted and will not accept audit engagements from new audit clients which contemplate the issuance by PMM of an auditor's opinion, in respect of financial statements which it is expected by PMM will be filed with the Commission within the next succeeding twelve-month period. Such limitation shall not include an audit client (i) in which a significant equity or debt interest is held or acquired by a present client of PMM, (ii) for which PMM has provided professional services since January 1, 1974 and prior to May 1, 1975, (iii) which is controlled by a foreign entity provided the financial statements of the client are not separately filed with the Commission, (iv) which is a client or a subsidiary or division of a client of a foreign affiliated firm of PMM, (v) which since July 1, 1974 and prior to May 1, 1975 has communicated with PMM concerning the possible engagement of PMM as its auditor (the Commisison having been advised of the number of such instances), or (vi) if its acceptance by PMM as an audit client is approved in the particular circumstances by the Chief Accountant of the Commission.

compensation and expenses will be borne by PMM. The members of the Committee will be chosen by PMM from a list of persons acceptable to the staff of the Commission.

b. The joint understanding of the Commission and of PMM concerning the examination is outlined in a memorandum addressed to the Committee. The memorandum is Annex B to PMM's offer of settlement.

c. It is contemplated by the Commission and by PMM that the examination can be completed and the report of the Committee submitted within six months.

d. PMM will promptly take all steps reasonably necessary and appropriate to adopt and implement any reasonable recommendations the Committee may make with respect to the manner in which such audit practice is conducted, provided, however, that, if PMM demonstrates to the satisfaction of the Commission that a recommendation of the Committee is not reasonable or need not be implemented either in the form recommended or with reasonable modifications, such recommendation need not be adopted.

e. The contents of the investigation, the working papers and other documentation (except the Committe's report) and the deliberations of the Committee will be held confidential except from PMM and the Commission.

3. PMM will promptly take all steps reasonably necessary and appropriate to adopt and implement the procedures contained in Annex C to PMM's offer of settlement. PMM will notify the Chief Accountant of the Commission prior to any amendment of such procedures within the next five years.

4. PMM will conduct a study of the use of the percentage of completion method of accounting and establish guidelines in this area for its audit practice, which will be applied in the conduct of its audits for fiscal years beginning on or after December 27, 1975.

5. For the six-month period from May 1, 1975 through October 31, 1975, PMM has not accepted and will not accept audit engagements from new audit clients which contemplate the issuance by PMM of an auditor's opinion, in respect of financial statements which it is expected by PMM will be filed with the Commission within the next succeeding twelve-month period. Such limitation shall not include an audit client (i) in which a significant equity or debt interest is held or acquired by a present client of PMM, (ii) for which PMM has provided professional services since January 1, 1974 and prior to May 1, 1975, (iii) which is controlled by a foreign entity provided the financial statements of the client are not separately filed with the Commission, (iv) which is a client or a subsidiary of a division of a client of a foreign affiliated firm of PMM, (v) which since July 1, 1974 and prior to May 1, 1975 has communicated with PMM concerning the possible engagement of PMM as its auditor (the Commission having been advised of the number of such instances), or (vi) if its acceptance by PMM as an audit client is approved in the particular circumstances by the Chief Accountant of the Commission.

6. A review will be conducted in 1976 and in 1977 at PMM's expense of the matters considered under the AICPA program for the review of quality control procedures of multi-office firms and to determine whether PMM has taken all steps reasonably necessary and appropriate to adopt and implement the procedures described in Annex C to PMM's offer of settlement and any recommendation of the Committee (subject to the proviso stated in paragraph 2.d.).

a. Each review will be conducted by a panel operating under the AICPA program, or (if such a panel is not prepared to act) by the Committee or not less than three accountant members thereof, or (if the Committee or three of its members are not prepared to act) by a group of not less than three certified public accountants chosen by PMM from a list acceptable to the staff of the Commission.

b. The results of each review will be reported to the Commission and to PMM.

c. The contents of each review, the working papers, other documentation (except the report of its results), and deliberations of the reviewers will be held confidential except from PMM and the Commission.

7. The Commission retains jurisdiction of this proceeding.

ARTHUR YOUNG & COMPANY

277 PARK AVENUE
NEW YORK, N. Y. 10017

To the Partners
Peat, Marwick, Mitchell & Co.

We have reviewed the prescribed audit practice quality control procedures in effect at Peat, Marwick, Mitchell & Co. (United States) for the period from April 1, 1974 through March 31, 1975, as identified in the Firm's Quality Control Document dated March 1974, and in its practice manuals and other publications. We have also reviewed the implementation of these procedures at the Firm's Executive Office and at 18 operating offices selected by us from among the Firm's 100 operating offices in the United States. The selected offices have 32% of the Firm's U.S. professional audit personnel. To the extent we considered appropriate, we reviewed individual completed audit engagements for fiscal periods ended between April 1, 1974 and March 31, 1975. Our selection of engagements covered the principal segments of the Firm's practice. We did not include audit work performed outside the United States or audit engagements which were the subject of litigation. The reviewed engagements involved approximately 16% of the total charged audit hours of the operating offices we visited.

In a review such as we have performed, the definitiveness of our conclusions is necessarily affected by certain inherent limitations. It is not possible to document all elements of the exercise of professional judgment and, consequently, our tests could not produce conclusions with respect to every such judgment reached by the Firm's personnel in carrying out the audit engagements included in our review. Further, it is inherent in the exercise of professional judgment that knowledgeable accountants may reach different conclusions in a particular case, and there were a few instances where we had a reservation or an exception as to conclusions reached by the Firm's personnel. Also, in some instances, the written record of audit evidence was less complete than we consider desirable and, therefore, we necessarily relied, in part, on discussions with the Firm's personnel to ascertain the procedures performed. In forming our opinion, we have given due regard to the foregoing observations.

In our opinion, the prescribed audit practice quality control procedures of Peat, Marwick, Mitchell & Co. (United States) for the period April 1, 1974 through March 31, 1975 were appropriately comprehensive and suitably designed for a multi-office firm to conform with the requirements of generally accepted auditing standards. Substantial efforts have been expended on quality control procedures relating to the Firm's audit practice and comprehensive audit practice guidance material has been made available to audit personnel throughout the Firm. Further, in our opinion, the prescribed quality control procedures were generally being applied during the period at the Firm's Executive Office and in the other segments of the practice we reviewed. We were favorably impressed with the extent of the Firm's commitment to the conduct of its practice in accordance with professional standards.

November 21, 1975

Arthur Young & Company

Price Waterhouse & Co.

1251 AVENUE OF THE AMERICAS
NEW YORK, NEW YORK 10020
212-489-8900

April 30, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on
Reports, Accounting and Management
United States Senate
151 Russell Building
Washington, D. C. 20510

My dear Senator Metcalf:

In response to the request contained in your letter of April 8, I enclose copies of material, as listed on the attached index, relating to testimony or presentations before Congress and other bodies, as defined in your letter, since January 1, 1975. I hope this material will be helpful to you in connection with your study of federal accounting procedures relating to the accounting profession.

Sincerely,

John C. Biegler

Enclosures

PRICE WATERHOUSE & CO.

LIST OF ITEMS SUBMITTED IN RESPONSE TO
SENATOR LEE METCALF'S LETTER OF APRIL 8, 1976

JANUARY 1, 1975 TO APRIL 30, 1976

SUBMITTED TO
SUBCOMMITTEE ON REPORTS, ACCOUNTING AND MANAGEMENT
SENATE COMMITTEE ON GOVERNMENT OPERATIONS

APRIL 30, 1976

The attached list is in response to the letter of April 8, 1976, from Senator Lee Metcalf, asking for certain public presentations made by representatives of Price Waterhouse & Co. during the period January 1, 1975 to date.

To the best of our knowledge, we have identified all presentations made by representatives of our firm, either in our own behalf or on behalf of a client, on matters in connection with public hearings or responses to proposed rulemaking of a Federal or State legislative committee or of a Federal or State regulatory commission.

We have included for the subcommittee's information a report we prepared for the Public Utility Commission of the State of Alaska which was used in one of its public proceedings.

We have not included in our response any items in connection with an adjudicatory type proceeding on behalf of a client.

Price Waterhouse & Co.

April 30, 1976

PRICE WATERHOUSE & CO.

LIST OF ITEMS SUBMITTED IN RESPONSE TO
SENATOR LEE METCALF'S LETTER OF APRIL 8, 1976

JANUARY 1, 1975 TO APRIL 30, 1976

FEDERAL LEGISLATIVE COMMITTEE OR REGULATORY COMMISSION -

Presentation made on behalf of Price Waterhouse & Co. -

1.	March 14, 1975	Securities and Exchange Commission: Proposal to Amend Rule 4-02 of Regulation S-X, Consolidated Financial Statements
2.	March 20, 1975	Securities and Exchange Commission: Release 33-5549, Proposal on Disclosure of Interim Results
3.	May 20, 1975	Federal Trade Commission: Proposed Line of Business Reporting Form
4.	May 30, 1975	Securities and Exchange Commission: Releases 33-5549 and 33-5579, Proposals on Disclosure of Interim Results
5.	June 4, 1975	Securities and Exchange Commission: Hearings on Releases 33-5549 and 33-5579, Proposals on Disclosure of Interim Results
6.	July 17, 1975	Senate Select Committee on Small Business: Hearings on Small Business Tax Needs
7.	August 4, 1975	House Committee on Ways and Means: Hearings on Tax Reform
8.	September 29, 1975	House Subcommittee on General Oversight and Renegotiation, Committee on Banking, Currency and Housing: Bill to Extend Renegotiation Act of 1951
9.	November 28, 1975	Securities and Exchange Commission: Proposed Guides 61 and 3, Statistical Disclosure by Bank Holding Companies
10.	January 15, 1976	Joint Economic Committee: Hearings on Employee Stock Ownership Plans

11.	February 3, 1976	Securities and Exchange Commission: Proposal on Disclosure of Certain Replacement Cost Data
12.	March 23, 1976	Cost Accounting Standards Board: Proposed Standard, Accounting for Insurance Costs
13.	April 20, 1976	Securities and Exchange Commission: Public Meeting on ASR 177, Accounting Changes

Presentation made on behalf of Clients -

Gulf Oil Corporation

14.	February 5, 1975	Federal Energy Administration: Hearings on Section 211.26, Chapter II, Title 10, Code of Federal Regulations, Cost Certifications

City of Seattle, Washington

15.	April 12, 1976*	House Subcommittee on the Environment and the Atmosphere, Committee on Science and Technology: Hearings on Solid Waste

STATE LEGISLATIVE COMMITTEE OR REGULATORY COMMISSION -

Presentation made on behalf of Price Waterhouse & Co. -

16.	April 21, 1975	Committees on Finance and Ways and Means: Hearings on Proposed Mineral Severance Tax Act, State of Tennessee
17.	November 7, 1975	Insurance Department, Department of Commerce: Proposed Rule and Regulation 21, State of Arkansas

Presentation made on behalf of Clients -

Public Utility Commission

18.	January 1975	Public Utility Commission: Hearings on Revenue Requirements and Proposed Sewer Rates for Greater Anchorage Area, State of Alaska

* Only oral testimony presented.

Hackensack Water Co.

19. March 1975	Board of Public Utility Commissioners: Hearings on Revision in Rates, State of New Jersey

The Detroit Edison Co.

20. July 1, 1975	Public Service Commission: Hearings on Revision of Fuel Cost Adjustments, State of Michigan

Empire State Power Resource, Inc.

21. July 14, 1975 and other dates	Public Service Commission: Case No. 26798 on Sale of Capital Stock, State of New York

Yellow Cab, Inc.

22. July 17, 1975*	Public Utilities Commission: Hearings on Docket No. 934, Proposed Fare Changes, State of Colorado

Cook Industries, Inc.

23. November 5, 1975	Franchise and Excise Tax Study Committee: Hearings on State Income Taxation of Multi-state Corporate Activities, State of Tennessee

Cleveland Electric Illuminating Co.

24. December 1975	Public Utilities Commission: Hearings on Accounting Practices, State of Ohio

Southern Pacific Transportation Company

25. December 18, 1975	Special Subcommittee on the San Francisco Rail Commuter Service: Hearings re Commuter Operations Between San Jose and San Francisco State of California

* Only oral testimony presented.

City of Seattle, Washington

26. February 17, 1976 Senate Committee on Public Utilities, Transit and Energy: Hearings on Solid Waste Management, State of California

(Staff note: The enclosures from Price Waterhouse are retained in the committee files.)

STATEMENT
on
S. 2812 and S. 3428
REGULATORY REFORM BILLS
before the
SENATE GOVERNMENT OPERATIONS COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
ROSCOE L. EGGER, JR.
and
PHILIP M. KNOX, JR.
May 24, 1976

My name is Roscoe L. Egger, Jr. I am a partner of the accounting firm of Price Waterhouse & Co. I serve as a Director of the Chamber of Commerce of the United States and as Chairman of its Regulatory Reform Task Force which has been given the responsibility for developing the Chamber's position on reform of the regulatory process. Accompanying me are Philip M. Knox, Jr., a Vice President of Sears, Roebuck and Co. and a member of our Task Force, and Barry A. Friedman, the Staff Director of the Task Force. Following our prepared statement, Mr. Knox, Mr. Friedman and I will attempt to answer any questions you might have.

We appreciate this opportunity to appear before the Senate Government Operations Committee as it examines various proposals for regulatory reform. Our comments are directed to the general subject of regulatory reform as the National Chamber sees it; but, our particularized discussion will examine S. 2812, the Regulatory Reform Act of 1976, sponsored by Senators Charles Percy and Robert Byrd, and President Ford's Agenda for Government Reform Act, S. 3428, submitted by Senators Hugh Scott and Bill Brock.

We support the approach taken in S. 2812 and S. 3428, although we recommend certain improvements.

The Chamber has long been a proponent of improving the economy, efficiency and effectiveness of government functions. During the 93rd Congress, the Chamber submitted a statement to this Committee in support of bills that would have established a National Commission on Regulatory Reform. We were one of the first proponents of the budget reform process that culminated in the adoption by the Congress of the Congressional Budget Act of 1974 (P. L. 93-344). And on March 24 of this year, the Chamber's President, Richard L. Lesher,

came before this Committee to support S. 2925, the Government Economy and Spending Reform Act of 1976, sponsored by Senator Edmund Muskie.

Today, the National Chamber urges this Committee to embark on a new legislative initiative that will bring about an effective beginning in reform of the regulatory process in the Federal government.

Why Regulatory Reform is Needed

The existence of regulatory agencies dates back to 1863, when the Office of the Comptroller of the Currency was created, and 1887, which marked the creation of the Interstate Commerce Commission (ICC).

However, during the Seventies we have witnessed an unprecedented and dramatic growth of regulatory agencies, both independent and within the Executive Branch. Such agencies as the Consumer Product Safety Commission (CPSC), Environmental Protection Agency (EPA), Federal Energy Administration (FEA), Mining Enforcement Safety Administration (MESA), Occupational Safety and Health Administration (OSHA), to mention a few, are products of this era.

Professor Murray Weidenbaum, Director of the Center for the Study of American Business at Washington University, has calculated the federal budget figure for regulators at $3 billion a year, with a workforce of more than 74,000 individuals.[1/] To comply with the various rules and regulations developed by the agencies is an enormous expense for business. For example, Richard L. Terrell, Vice Chairman of General Motors Corporation, has reported that GM's regulatory compliance cost would amount to more than $1.3 billion this year.[2/]

An important point to note is that the cost of regulation falls not just on business, but ultimately on the consumer. The General Accounting Office has placed this cost at $60 billion annually. In just one item, automobiles, Professor Weidenbaum estimates that the federally mandated cost of a typical 1974 car was $320.

The plain fact is that every business must pass along all the cost of federal regulations to the consumer. It is essential that regulators take into consideration the trade-off between what they seek to accomplish and the criteria that are important to consumers.[3/] There is little evidence that any consideration is being given to this question.

It is now time to reexamine the regulatory process. We applaud the fact that this Committee, along with the Senate Commerce Committee, has

been authorized to study the purposes and effectiveness of the federal regulatory process. We hope the results of these studies will provide guidance and direction for Congress. At the same time, we feel that action at the individual agency level is essential.

The National Chamber is dedicated to a competitive free market economy operating in today's world on a basis consistent with the role of government in safeguarding the health, safety and welfare of our fellow citizens. But it is essential that both cost and benefits of government programs be taken into consideration -- and that regulators not lose sight of the fundamental purposes of the programs, what can and should be accomplished and whether the costs, ultimately borne by the public, justify each action. For too long, the regulatory process has gone without this type of fundamental accountability. Senator Percy, in a recent speech, recognized the extent of this problem when he said: "It seems that the dynamism of the American economy is matched only by the rigidity and inflexibility some of the agencies which regulate it."[4/]

The Chamber's Goals

The National Chamber's Task Force on Regulatory Reform, recently created, is composed of individuals representing a broad range of professional, business, and trade association members of the Chamber.

This group sought to develop for the Chamber a philosophy of regulatory reform and a set of basic principles to be applied in the process of reform. In brief, we believe that Congress, which passed the legislation creating regulatory agencies and provided their authority, should take the initiative to provide the legislative mandate and the mechanism for reform. What is needed is broad-gauged review of the functions and activities of all agencies having regulatory responsibilities. In conducting such a review, Congress should spell out specific criteria to serve as the basic guidelines in carrying out an effective reform program.

The task of setting standards or criteria for government regulation is delegated, under our political system, to the Legislative Branch. Congress has the ability to establish goals and require results from programs created to achieve those goals. And, through its oversight functions, Congress should require accountability from those designated to administer and carry out legislated programs.

We believe it is a proper role of Congress to determine whether, and to what extent, those in a regulatory function, in their zeal, have gone too far, and have perhaps carried regulation to excess. No particular purpose will be served in detailing to this Committee a long list of examples of excessive regulations.

The Chamber's Board of Directors, during its February 1976 meeting, considered and endorsed recommendations prepared by the Task Force. Our Board enunciated basic principles which we believe should be written into the law to provide effective regulatory reform:

> A competitive free market system should be retained and encouraged to provide an incentive for innovation, and to give consumers the maximum range of choices.
>
> Regulation should be only that essential to the protection of health, safety and the general welfare, and should be revised and administered so as to:
>
> 1. Provide that degree of regulation essential to the proper functioning of a competitive free market system, keeping in mind the need for, and the feasibility of, regulation consistent with foregoing principles;
> 2. Eliminate uneven and inequitable enforcement;
> 3. Eliminate regulatory duplication and conflict;
> 4. Provide for prompt regulatory decisions consistent with due process;
> 5. Assure adequate consideration of costs and benefits;
> 6. Minimize compliance costs;
> 7. Provide federal preemption only in those instances where federal regulation is essential; and
> 8. Assure a more orderly development of regulation, with the Congress establishing basic policy, agencies regulating in accord with the intent of Congress, and the Congress reviewing regulatory actions within its oversight function.

We believe these foregoing principles are of the utmost importance. We believe they should be incorporated in any program for reexamination of the regulatory process, and with this in mind we would like to elaborate on each point.

Proper Degree of Regulation

We realize that some level of government regulation must exist. Regulation of a sort seems mandatory in our complex world. At the same time, regulatory agencies may well have gone far beyond the essential level. Today, the effects of over-regulation very often threaten the continued preservation of competition in our market economy.

We have all been exposed to the stories of business forced to shut down, or to suspend or cut back operations due to excessive regulations. For others, it becomes just another component of the cost structure -- but, alas, paid for by the consumer.

It is time for regulators to be required to become conscious of how their actions affect competition. The market place must be permitted to function function in a way that will encourage, not discourage, initiative and innovation. The key point should be to assure that consumers have a maximum range of choices in the selection of goods and services in the market. Studies of government regulations must determine whether the regulatory activity is really necessary under today's conditions.

Uneven and Inequitable Enforcement

This is an area of vital concern to our members. The degree of complexity built into regulations in many areas is such that the ability of the agency to achieve even-handed enforcement is impaired. Over pre-occupation with a single narrow objective frequently precludes solving material problems.

Agencies concentrating on a single task or narrow field frequently develop points of view totally unresponsive to the group being regulated. All too frequently, individual bias is permitted to influence the decision-making process.

Ways must be found to assure that the true objectives of the regulatory action be given recognition -- that the public interest and questions of public policy not be ignored.

Duplication and Conflict

This facet of regulation has no known justification. The businessman is caught between the scylla and charibidis of regulators. What can he do when the occupational safety officer determines that certain equipment is unsafe for the worker's occupational health and the environmental inspector considers the same equipment to be the best protection against water, air or noise pollution?

This is an everyday problem of the businessman. At least a minimum standard of common sense and coordination of effort should be mandatory.

Prompt Decisions

Senator Percy often refers to the Rock Island case which has yet to be resolved after years of delay. This example points up the problems facing business. Prompt decision-making is essential to the efficient functioning of any enterprise. No business could survive in the state of disorder in which we find our regulatory agencies. The Equal Employment Opportunity Commission backlog is just such an example. The result is that firms are kept in a form of regulatory limbo. They do not know how to proceed. One can hardly contemplate the enormous cost of this delay.

Level upon level of review, failure to clearly place authority and fix responsibility, and over-concern with trivia all contribute to the lack of efficiency in agency after agency. These are typical management problems which need to be addressed.

Minimize Compliance Costs

We have already mentioned the enormous costs imposed on the public because of the expense of meeting regulatory orders. Some basic ground-rules of cost justification are needed in regulatory orders. The agencies should promulgate regulations with compliance in mind. Will the cost of compliance outweigh the benefits to be obtained? Will the requirements to meet the compliance goals drive firms out of business and reduce competition? And what about enforcement? All too frequently, the solution to a compliance problem ignores cost as an important consideration. Yet, it is axiomatic that any activity of a regulatory nature generates costs before there can be any benefits.

Preemption

Federal preemption should occur where federal regulation is essential. While we believe that federal regulators are involved in far too many aspects of our lives, we do recognize that under certain conditions there is a need for federal preemption. Where there is such a degree of conflict among jurisdictions that business cannot function in interstate commerce, then there is a need for the same rules to apply everywhere so that businesses can best serve their customers economically and efficiently.

Orderly Government

Many of our members feel that the Congress has abdicated too much of its responsibility to the independent agencies. Some believe the Congress has

too often merely passed broad general statutes to achieve obviously worthy objectives only to leave entirely to the independent agency created to administer the program the real chore of devising the solutions.

We believe it is time for the Congress to reassert its responsibility in this matter. We recently found a good reception to this view when the Chamber testified before the Subcommittee on Activities of Regulatory Agencies of the House Small Business Committee on this very subject. The Representatives agreed that Congress must get more involved in the regulatory process.

We recommend that legislation more clearly specify its objectives, those goals to be achieved -- in that the regulators be directed to adhere to Congressional intent. Congress, through its oversight function, must continually monitor the activities of the agencies to see that the objectives are being achieved. In other words, Congress must accept the ultimate responsibility for the success or failure of programs emanating from legislative action.

With these points in mind, the Task Force reviewed many of the proposals now before this Committee, the Senate Judiciary Committee, and their House counterparts. Among the bills that take a sound and beneficial approach to regulatory reform are S. 2812 and S. 3428.

<u>What S. 2812 Provides</u>

The goal of S. 2812 is to conduct extensive review of the activities of the regulators over a five-year period. The review process is designed to produce agency reform plans for submission to Congress and eventual enactment into law. In conducting the review and preparation of plans, the various agencies are to strive for organization efficiency, development of broad policy guidelines, and an improvement in slow-moving, case-by-case decision-making.[5/]

The bill requires that plans contemplate the combination, elimination or transfer of agency functions. Procedures are to be streamlined. In some instances, there may be justification for merging, modifying or abolishing regulators or even entire agencies. Of primary importance is the call to modernize operations and improve efficiency.

At the heart of this bill is an action-forcing mechanism. The legislation requires that plans be submitted in each of the five years and provides also the time frame within which the agencies, Congress and the President must act on the plans. Senator Percy, in introducing the legislation, spoke of the necessity for the timetable for action. He said, "Unless we establish a

framework for a timely and coordinated response to the full range of regulatory problems, the present initiatives of Congress and the President may be dissipated in a matter of months, leaving hidden facets of the problem untouched." 6/

S. 2812 provides that on March 31 of each year, from 1977 until 1981, plans for segments of the regulatory spectrum are to be submitted. The order of review as stipulated in the bill, is: banking and finance: followed by energy and the environment; commerce, transportation and communications; food, health, safety and unfair and deceptive trade practices; and finally, labor-management violations, housing, government procurement and small business.

Other agencies may be added by the President or the Speaker of the House and President pro tempore of the Senate.

The timetable does not stop with the submission of a plan to Congress. Upon receiving a plan, the appropriate oversight committees along with the House and Senate Government Operations Committees are to examine the proposals. A plan, whether or not one is submitted by the President, becomes the pending business of both Houses by September 15 of the year of submission. If no plan is enacted by December 31 of the year of submission, the President's plan becomes law on March 15 of the year following submission. If a plan is disapproved by either House, the Congress has until the end of June of the year following submission to act. If no plan is enacted and none has automatically become law, rules of the affected agencies lose their force and effect on June 30 of the year following submission of the plan to Congress.

The Reservations We Have With S. 2812

Our Task Force has examined S. 2812 in detail. We are in general agreement with the concepts of the bill. However, our analysis suggests several respects in which the proposed legislation could be improved. The following aspects are of particular concern to us:

- The findings and Purposes Provisions in Section 2(a), 2(a)(1) and 2(a)(2) contain conclusions which we believe add little to the legislation and may detract from the main thrust of the substantive provisions.

- The directions for the plans should be more specific.

- There should be more flexibility allowed for the President to designate the subjects to be studied during each year and the agencies and activities which will be incorporated in each year's study.

The Findings and Purposes Are Overstated

The Findings and Purposes Provisions, found in Section 2(a) detract from the genuine purpose of the bill. S. 2812 should be a positive piece of legislation that seeks better regulation. Although the introductory provision contains language intended to form the basis for, and state the reasons for, the remaining provisions, the language contains excessive overstatements.

We recognize, of course, that some regulatory policies have been anti-competitive. In some instances that may have been justified. In some, it probably was not. This is a bill that should be of a positive nature. It should look forward to the objective of an effective government, not backward at excesses of the past. This section should be tempered along the lines of S. 3428.

The Directions Provisions Should Be More Specific

Section 2(c), which offers the initial guidance as to the agency plans, is too narrowly drawn. It should specify the objectives to be sought by the individual agencies in developing plans. It will not be an easy task for the agencies to reevaluate themselves. They need more specific guidance from Congress. The bill's rather strict timetable leaves little room for reconsideration of agency plans. Section 2(c) should set forth the basic criteria to be incorporated into each agency plan. This will assist the agency in plan development and Congress in plan review.

We suggest that at a minimum, each agency plan should include:

- A definitive statement of the extent to which the plan will enhance competition in the area of commerce or industry involved.
- Cost benefit analyses for programs.
- Detailed plans for personnel and resource utilization.
- Studies of agency goals and agency ability to accomplish these goals, together with appropriate controls to assure that activities and regulations are consistent with, and not in excess of, those required to achieve the goals.
- Offices that will provide the agency head with policy and program evaluation of the agency (we offer the Office of Policy Planning and Evaluation at the Federal Trade Commission as an example).

The timetable as presently drafted is too rigid. Flexibility is essential in this area. It would be difficult, if not impossible, to anticipate all of the

priorities or needs in the process of an across-the-board review of the regulative functions of the federal government. The President should be permitted to decide what group or functions will be examined each year. Such decisions will undoubtedly change from time to time as the inquiry progresses. The President must be able to take into consideration those topics and matters needing immediate examination. It is sufficient to set an overall timetable, together with progress targets, to assure that the project moves ahead. However, any attempt to forecast the precise order of priorities in such an undertaking is unrealistic.

One advantage we see is that the President can truly develop a program of regulatory reform. Properly done, each new year's package can build on the previous year's work. Experience and lessons learned as the work progresses will assure progressively better results. Let us not forget that the principal virtue of this bill's approach is to provide a mechanism through which meaningful results will be achieved.

Five years is a long time. Factors influencing regulatory evaluation will change over this period. Our proposals for this change do not alter the schedule set by S. 2812. In either case the timetable discipline should be retained.

The listing of specific agencies, found in Section 4(a), warrants further analysis. Again, this structure requires more flexibility. In our review, we noticed important agencies not included in these listings. These include, for example, the procurement activities of the Department of Defense and the export-import programs of the Department of Commerce.

We are aware that Section 4(b) contains wording allowing for other agencies to be added. However, this function should not be undertaken by Congress. Congress is to set the goals. The Executive Branch should carry out the activities to achieve the desired result. Thus, it is more appropriate that the selection of agencies and activities to be examined should properly be left to the Executive Branch. Of course, the oversight function to be carried out by Congress will ensure that all agencies are covered. This procedure utilizes the proper functions of both branches of government.

Another problem we have is the groupings. We are in general agreement with the broad titles: banking; energy and environment; commerce, transportation and communications; food, health and safety, and unfair or deceptive trade practices; and labor, housing, government procurement, and small business. However, the current structure in which specific agencies are mentioned reveals some inconsistencies. We have wondered, for instance, whether the National Highway Traffic Safety Administration which is now listed under safety, might better go with transportation, or whether the Nuclear Regulatory Commission, now under energy, might better be under safety or whether there should be listings in more than one classification for each agency. Better results might follow if the decisions as to the timing of studies or groupings of the agencies to be examined are left to those required to carry out the review.

What S. 3428 Provides

We applaud the President's interest in regulatory reform. This is a subject which requires the attention and the involvement of all branches of our government, and the show of support by the Executive branch is especially welcome.

S. 3428 appears to be modeled on the approach taken by Senators Percy and Byrd in S. 2812. It calls for a four-year program to be conducted starting in 1978. The various agencies would be required to submit reform plans affecting the various industrial sectors of the economy. This is a departure from the Percy-Byrd plan which focuses specifically on the agencies and not the industries affected by the agencies. We have not had enough time to fully consider this approach. Thus, we will defer comment.

The order prescribed in S. 3428 is unique. The schedule calls for transportation and agriculture in one year; then mining, heavy manufacturing, and public utilities; light manufacturing and construction; and communications, finance, insurance, real estate, trade and service industries.

One aspect of this ordering is of special significance. There is enough flexibility for the President to add agencies that he deems necessary. As we have just indicated, the National Chamber favors this flexibility.

The plans are to include material in seven areas. We note that the proposal focuses on points of concern to us: enunciation of purposes, focusing on goals, specific cost-benefit information and analysis of expected and realized impacts. These are the types of information we have already characterized as essential. We submit that these points might even be made more specific.

The primary difference between S. 2812 and S. 3428 lies in the action-forcing provisions. The President's bill drops the aspects that deal with Congressional failure to act. It does not go beyond requiring the legislation to become the pending order of business in Congress as of a certain date.

Our analysis to date leads us to believe that the action-forcing mechanism may be more effective. Absent is a real opportunity to consider the proposed alternatives. We wish at this time to support the general approach in S. 2812. Some individuals have raised constitutional objections to S. 2812's provisions that automatically turn legislative proposals into law and practical objections to agencies losing their powers to promulgate rules, etc. On the basis of the National Chamber's support of a time table approach we can accept either approach and ask this Committee to adopt the one it finds to be the soundest method for gaining regulatory reform.

Some Observations on S. 3428

The tone of this bill is extremely reasonable and takes note of the concerns of business. For instance, the Findings and Purposes Section does not contain the harshness of S. 2812. Rather, it reflects the need for concerted action.

This is especially evident in the educational implications of the bill. We are favorably impressed by the provision that calls for obtaining the views of concerned Americans. We know that there are many members of the National Chamber who are ready to assist in gaining regulatory reform.

In sum, we certainly can and do favor the approach taken by S. 3428. We realize that there are certain problems with the bill. For instance, will the Congress be in session on November 15 of each year, and will the new President in 1981 be able to present a plan on January 30? It is the opportunity of this Congress to merge the best parts of S. 2812 and S. 3428 and come up with a bill that can achieve concrete results.

Action Is Needed

It is now time to act on regulatory reform. We have talked a good deal about the need for reform. Senator Percy has participated in discussion programs at our last two annual meetings in which regulatory reform was the topic. He and others have seen the keen interest on the part of our members for revamping and improving government. President Ford chose our 1975 Annual Meeting to give a major address on regulatory reform.

Business, large and small, wants a better,more efficient and effective government that is responsive to the needs of today in today's economic environment.

Summary

We offer our general approval of S. 2812 and S. 3428. If adopted in a manner which incorporates our suggestions, these bills can accomplish the kind of broad-gauged reform of the regulatory process that is so urgently needed.

We urge that this Committee follow our suggestions and report these pending regulatory reform bills with the modifications we have recommended.

1. Weidenbaum, Regulation or Over-Regulation? The Wall Street Journal, April 6, 1976, at 22.

2. New York Times, January 17, 1976 at 35.

3. See J. F. Weston, Economic Aspects of Consumer Product Safety in Issues in Business and Society 499 (1972).

4. Address of Senator Charles H. Percy, presented to the Executives Club of Chicago, March 24, 1976 at 10.

5. Section 2(c) of S. 2812.

6. 121 Cong. Rec. S. 22655 (December 18, 1975).

(From the Wall Street Journal, Apr. 11, 1975)

Price Waterhouse Knew United Brands Paid Bribe but Didn't Require Disclosure

By Frederick Andrews
Staff Reporter of The Wall Street Journal

NEW YORK—Price Waterhouse & Co., outside auditor of United Brands Co., knew of the $1,250,000 bribe paid by United Brands to a Honduran official, but didn't require its disclosure for fear of jeopardizing the company's operations there by embarrassing the Latin American nation's government.

In an interview, Walton W. Kingsbery, partner in charge of auditing United Brands, said Price Waterhouse concluded it hadn't any duty to override United Brands' decision to ask the Securities and Exchange Commission to keep the bribe secret. "We believed the route they were taking was reasonable," Mr. Kingsbery said. He also said Price Waterhouse discussed its decision with the SEC, which didn't raise any objection.

John C. Burton, SEC chief accountant, declined last evening to comment on Mr. Kingsbery's statement.

Bribe Wasn't Mentioned

The $1,250,000 bribe, disclosed earlier this week, was paid by United Brands last year to secure a reduction in the Honduran export tax on bananas. On Wednesday, the SEC charged United Brands with issuing false reports to hide the payment, but the SEC didn't accuse Price Waterhouse of anything improper. A stockholder suit brought yesterday against United Brands didn't name Price Waterhouse either.

Price Waterhouse's audit letter, dated March 31, 1975, and filed with the SEC as part of United Brands' required 10-K annual report for 1974, mentions neither the $1,250,000 bribe, nor the company's request to the SEC for confidentiality. The Price Waterhouse opinion is qualified on several grounds, however, including the uncertain impact of the new taxes imposed last year by banana-producing countries.

As part of an explanation of those qualifications, the Price Waterhouse letter does refer the reader to "Risk of Foreign Operations," another section of the lengthy 10-K filing. That section, an 11-paragraph recitation of United Brands' tax troubles in Panama, Costa Rica and Honduras, concludes as follows: "Certain information has been omitted from this Annual Report on Form 10-K and is being filed separately with the Securities and Exchange Commission, together with an application to the Commission for a determination that such information be kept confidential. . . ."

Opinion Letter Defended

With that reference in mind, Henry P. Hill, another Price Waterhouse partner, defended the opinion letter. "The opinion, in all fairness, does draw attention to this thing," he said.

If Price Waterhouse had qualified its opinion because of the bribe or the confidentiality request, an explicit mention of this in its audit letter would have been required. Normally, an auditor qualifies an opinion because of important uncertainties or contingencies that could affect a company.

According to Mr. Kingsbery, Price Waterhouse decided the bribe payment didn't itself create such a contingency. Any uncertainty about United Brands' financial picture—such as the possible loss of its Honduran properties—would arise only from disclosure of the bribe, the audit firm concluded. So as long as the payment remained secret, a need didn't exist to qualify the opinion, Mr. Kingsbery said.

Mr. Kingsbery said Price Waterhouse learned about the $1,250,000 bribe during its audit of United Brands for 1974 but declined to say how Price Waterhouse found out. He described the audit firm's decision as "a judgment call" involving many factors, but said the decisive point was concern that disclosure would hurt the company by provoking the Honduran government. Price Waterhouse realized that the bribe might become known in spite of the company's request to the SEC, but decided that the risk didn't warrant a qualification, Mr. Kingsbery said.

"See Your Attorney"

Currently, the accounting profession is extremely troubled by uncertainty over its responsibility for reporting improper payments by corporations they audit. This concern was brought to the fore by the discovery of illegal campaign contributions by a score of well known corporations. (They included the discovery of a $10 million political slush fund at Gulf Oil Corp., a major Price Waterhouse client.)

One point of concern is what chance a routine audit has of bringing such payments to light. Beyond that, however, audit doctrine doesn't give much guidance on what an auditor should do even if he stumbles on an improper payment. Typically, the sums are small by normal audit standards, and often they are defended as necessary in the company's best interests. Regulatory authorities haven't given auditors much guidance, either. "I'd probably tell them to go see their attorney," suggested the SEC's Mr. Burton in an earlier interview unrelated to the United Brands matter.

From the Wall Street Journal, May 11, 1976

General Tire Accused by SEC Of Broad Payoffs

Charges Are Most Extensive Since Study Was Begun; Firm Plans Investigation

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—The Securities and Exchange Commission accused General Tire & Rubber, Co. of a wide array of foreign and domestic payoffs, including some to get off the Arab boycott list.

General Tire, without admitting or denying the SEC allegations, agreed to a court injunction barring future law violations. The company also agreed to set up a special review committee, made up of outside directors, to conduct a thorough investigation and report publicly on any improper activities by the company and its employes.

The complaint—the broadest against any company since the SEC began its foreign-payoffs investigations over a year ago—charges the concern with making illegal political contributions in the U.S., paying "gratuities" to military and civilian employes of U.S. agencies with which General Tire does business, overseas bribes, violations of foreign-currency laws, unrecorded "slush" funds and overbilling of foreign affiliates for supplies.

Further, the company and its president, Michael Gerald O'Neil, are accused of setting up and maintaining for many years elaborate schemes to get around the laws of the U.S. and various foreign countries.

May Affect FTC Inquiry

Some of the allegations, which include four instances where General Tire is accused of making foreign payoffs to gain an advantage over competitors, could well prod the Federal Trade Commission to intensify its antitrust inquiry into General Tire. That investigation, disclosed last month, is the first known attempt to use antitrust laws in the government's crackdown on foreign payoffs.

General Tire also has problems pending at a third federal regulatory agency, the Federal Communications Commission. Many of the charges made by the SEC already had surfaced in documents filed with the FCC by a group that is competing for a Boston television license held by a General Tire subsidiary.

The company itself previously disclosed some of the questionable payments cited by the SEC in its complaint. However, the SEC went considerably farther in alleging that they reflected established company practices and in tying General Tire's Akron, Ohio, headquarters to allegedly improper activities.

For instance, the SEC charged that about eight years ago Mr. O'Neil directed that top company executives were to be given bonuses or salary increases "with the understanding" that the executives were to use a portion of these funds for domestic political contributions. The recipients, who weren't identified in the SEC suit, were "for the most part" designated by Mr. O'Neil or others acting at his direction, the SEC alleged. It charged that at least $65,000 was disbursed for political contributions to candidates for state and federal offices and that "a substantial portion" may have been illegal. It's against U.S. law to use corporate funds for candidates for federal political office.

Further Allegations

Sometimes, according to the SEC complaint filed in federal district court here, the executives were directed to issue checks payable to "cash." An assistant to Mr. O'Neil would endorse the checks and either deposit the proceeds in a bank account designated the "General Tire Good Citizenship Fund" or place the cash in a wall safe in his office, the complaint alleges. On occasions, the SEC charged, Mr. O'Neil obtained reimbursements from the wall safe for political contributions he made.

The 25-page SEC complaint contains only one paragraph referring to the gratuities allegedly given to U.S. government officials with whom General Tire was negotiating contracts. It charged that the benefits included the use of General Tire's corporate aircraft and payment of "various miscellaneous expenses of government employes." The company's special review committee was specifically directed to look into this area, and further details could emerge when the committee makes its report, due by year-end.

For assistance in its successful effort to get off the Arab League's boycott list, the SEC said General Tire retained Perco Establishment, an affiliate of Triad Financial Establishment, which is headed by Adnan Khashoggi, the controversial Saudi Arabian businessman. General Tire previously said that it paid $150,000 to the firm for help in getting off the blacklist, insisting that it was a legitimate business transaction. Mr. Khashoggi, a sales agent for several U.S. aerospace concerns, previously denied allegations that he passed on bribe money to Arab government officials.

The SEC also charged General Tire failed to disclose that it filed a sworn certification with the Arab League in 1971 stating that the company and its subsidiaries wouldn't give any technical service or know-how to any Israeli company, that its Aerojet-General Corp. subsidiary wouldn't invest in Israel or furnish any technical assistance to Israeli industry and that General Tire would try to persuade its East African affiliate to refrain from importing any Israeli tires or other products for distribution.

Slush-Fund Charges

Perhaps the most elaborate scheme outlined in the SEC's charges concerned the alleged maintenance of slush funds that weren't recorded on the company's books. The agency charged that from the late 1950s until at least early 1975, General Tire

"systematically violated" contracts with many of its foreign subsidiaries by inflating the cost of supplies shipped to the subsidiaries. Most of General Tire's foreign affiliates are joint ventures with foreign governments or private foreign groups, according to the SEC.

The contracts with the foreign subsidiaries provide that General Tire will charge subsidiaries only the cost of the supplies plus related shipping charges and a percentage commission, according to the SEC. However, the complaint charges that General Tire often received rebates from suppliers, which it failed to pass on to the subsidiaries. Instead, the proceeds of the rebates were put in an "income account" in Akron, the SEC charged.

Similarly, the complaint alleges, General Tire "systematically overbilled" affiliates in Morocco, Chile and other foreign countries and put the proceeds, which totaled at least \$3 million between 1960 and 1970, in accounts in Akron numbered "611." Funds from these accounts were used for "various improper purposes in Chile, Morocco and other countries," the SEC charged.

It added that because most of General Tire's affiliates were owned substantially by shareholders that weren't affiliated with General Tire, the company's use of the 611 accounts and the income account "may have deprived the nonaffiliated shareholders of their proportionate share of financial benefits."

Mexican Trade Association

Another aspect of the SEC's allegations involved use of a trade association in Mexico, known as the Chamber of Rubber Manufacturers. The SEC charged that the association's manager received payments from General Tire's Mexican subsidiary and five other major tire companies "to finance his effort to obtain government approval of a proposed price increase."

According to the SEC complaint, the Mexican subsidiary, General Popo S.A., paid the trade association manager between \$50,000 and \$80,000 from an off-the-books cash fund, generated through illegal rebates from transporters. "Nominal payments" to government officials also were made from the fund, the SEC charged.

The SEC's descriptions of alleged foreign payoffs included several instances where Moroccan government officials were the intended recipients and at least one where the intention wasn't carried out. The SEC charged that General Tire wasn't able to forward payment for one deal to its Moroccan "consultant" because he was "imprisoned by the Moroccan government for making illegal payments to government officials in connection with a number of matters." The \$300,000 fee is "presently carried as an accounts payable on the financial statements of General Tire," the SEC said.

The allegations that are likely to interest the FTC include a charge, previously disclosed, that General Tire made a payoff in Morocco to obtain government approval to expand its local tire plant. "Related to the plant expansion was an effort by General Tire to retain a monopoly position in Morocco with respect to its production of tires," the SEC charged.

Alleged Payoffs in Chile

It also cited an instance where a Chilean consultant was paid \$100,000 for assistance in getting government approval of a price increase and in "influencing the government of Chile to refrain from granting an operating license to any other tire company." Another \$4,000 was paid to an agent for "expenses in connection with an attempt to dissuade a French banking institution from granting a loan to another U.S. tire and rubber firm, which was attempting to build a tire plant in Chile," the SEC alleged.

Further, the SEC charged that, with the knowledge of General Tire, its Chilean affiliate bought substantial amounts of stock in a Chilean tire distributor. The move was intended to prevent the distributor from entering into an agreement with a new plant to be operated by another U.S. tire and rubber company, the SEC complaint alleges.

In Akron, General Tire said: "In agreeing to the judgment, the company doesn't admit any wrongdoing. The agreement to settle has eliminated the expense of litigation and other expenses on behalf of the company. It's neither appropriate nor prudent for the company to comment further on these matters until the required investigation has been completed, and the required written report becomes public when filed with the SEC and the court."

General Tire identified its five independent directors who will perform the investigation as D. S. Henkel, partner in the New York law firm of Sullivan & Cromwell; L. D. Henry, consultant, Avco Corp., Greenwich, Conn.; D. B. Mansfield, director and retired president, Ohio Edison Co., Akron; J. T. Morley, retired consultant, NCR Corp., Dayton, Ohio, and Dr. W. B. Walsh, president, People-to-People Health Foundation Inc., Washington, D.C.

The SEC said that the special counsel aiding the group will be Richard F. Stevens of the Cleveland law firm of Baker, Hostetler and Patterson.

TOUCHE ROSS & CO.
1633 BROADWAY
NEW YORK, NEW YORK 10019

RUSSELL E. PALMER
Managing Partner

April 30, 1976

Honorable Lee Metcalf
United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

I am pleased to forward copies of testimony and presentations that meet the criteria specified in your letter of April 8, 1976. Each copy is identified with a numbered label, and a listing of these items in alphabetic order by states is enclosed, as Attachment A.

In those cases where copies of testimony or presentations are not available, a listing including a brief description of the presentation and the agency to which submitted is provided, as Attachment B.

I trust this information will facilitate your study of the accounting profession.

Respectfully,

Russell E. Palmer

ATTACHMENT A - LIST OF TOUCHE ROSS & CO. TESTIMONY AND PRESENTATIONS ENCLOSED

GOVERNMENTAL UNIT	DEPARTMENT/AGENCY	SUBJECT	WITNESS/AUTHOR	DATE
1. Arizona	Arizona Corporation Commission	The Mountain States Telephone and Telegraph Company Docket No. 9981-E-1051	Kenneth M. Stevens	
2. Arizona	Arizona Corporation Commission	The Mountain States Telephone and Telegraph Company Docket No. 9981-E-1051	Pat A. Loconto	
3. Arkansas	Arkansas Public Service Commission	Arkansas Power and Light Company Docket No. U-2649	Frank R. Budetti	October 7, 1975
4. Arkansas	Arkansas Public Service Commission	Arkansas Power and Light Company Docket No. U-2649	Kenneth M. Stevens	October 7, 1975
5. Arkansas	Arkansas Public Service Commission	Southwestern Bell Telephone Company Docket No. U-2597	Kenneth H. Stocke	May 16, 1975
6. Arkansas	Arkansas Public Service Commission	Southwestern Bell Telephone Company Docket No. U-2597	Douglas H. Wilton	May 16, 1975
7. Arkansas	Arkansas Public Service Commission	Southwestern Bell Telephone Company Docket No. U-2597	Pat A. Loconto	May 16, 1975
8. Arkansas	Arkansas Public Service Commission	Southwestern Bell Telephone Company Docket No. U-2597	Frank R. Budetti	May 16, 1975
9. Kansas	State Department of Corrections	Eight-year master plan for submission to the legislature	Touche Ross Kansas City office	January, 1976
10. Kentucky	Kentucky Public Service Commission	Louisville Gas & Electric Case No. 6220	Pat A. Loconto	June, 1975
10a. Exhibit to above.				
11. Maryland	Public Service Commission	In the matter of application of Potomac Electric Power Company for a temporary and permanent increase in its retail rates for sale of electric energy	Donald J. Trawicki	December, 1975
12. Massachusetts	Department of Banking and Insurance	Letter to Deputy Commissioner re Hearing on Proposed Regulation for insurance companies to file certified statements	Art Hills	October 9, 1975 December 10, 1975
13. Michigan	Michigan Senate Taxation Committee	Project to perform an analysis of the proposed business privilege tax final report	Touche Ross Detroit office	May 6, 1975 (Revised May 8, 1975)
14. Michigan	Michigan Public Service Commission	Overall Management Improvement Project Executive Summary Report	Touche Ross Detroit office	May 28, 1975
15. Minnesota	Minnesota Public Service Commission	Northwestern Bell Telephone Company Department of Public Service Docket No. U-75-496	Kenneth M. Stevens	April, 1976
15a. Exhibit to above.				
16. Minnesota	Minnesota Public Service Commission	Northwestern Bell Telephone Company Department of Public Service Docket No. U-75-496	Pat A. Loconto	April, 1976
16a. Exhibit to above.				

ATTACHMENT A - LIST OF TOUCHE ROSS & CO. TESTIMONY AND PRESENTATIONS ENCLOSED
(continued)

GOVERNMENTAL UNIT	DEPARTMENT/AGENCY	SUBJECT	WITNESS/AUTHOR	DATE
17. Minnesota	Minnesota Public Service Commission	Northwestern Bell Telephone Company Department of Public Service Docket No. U-75-496	Kenneth A. Hagstrom	April, 1976
17a. Exhibit to above.				
18. Minnesota	Minnesota Public Service Commission	Development of Rules relating to the Regulation of Gas and Electric Utilities in Minnesota under the Public Utilities Act of 1974	Touche Ross Detroit office	September 1974 to February 1975
19. Minnesota	Minnesota Public Service Commission	Northern States Power Company Docket No. ER-2-1	Kenneth H. Stocke	June 27, 1975
19a. Exhibit to above.				
20. Minnesota	Minnesota Public Service Commission	Northern States Power Company Docket No. ER-2-1	Pat A. Loconto	June 27, 1975
20a. Exhibit to above.				
21. Minnesota	Minnesota Public Service Commission	Northern States Power Company Docket No. ER-2-1 (Supplemental Testimony and Exhibit)	Kenneth H. Stocke	July 18, 1975
22. Minnesota	Minnesota Public Service Commission	Northern States Power Company Docket No ER-2-1	Frank R. Budetti	August 15, 1975
23. Minnesota	Minnesota Public Service Commission	Continental Telephone Company of Minnesota, Inc. Docket No. PR-121-1 re Revenue Requirements	Kenneth A. Hagstrom	August 22, 1975
24. Minnesota	Minnesota Public Service Commission	Continental Telephone Company of Minnesota, Inc. Case No. PR-121-1 re Fair Rate of Return	Kenneth M. Stevens	September, 1975
25. Minnesota	Minnesota Public Service Commission	Northwestern Bell Telephone Company Docket No. M-5405, on remand from Ramsey County District Court, re Western Electric Pricing.	Pat A. Loconto	December 10, 1975
26. Minnesota	Minnesota Public Service Commission	Northwestern Bell Telephone Company Docket No. M-5405, on remand from Ramsey County District Court, re Obsolescence and Rate of Return.	Kenneth A. Hagstrom	December 10, 1975
27. Nebraska	Department of Public Institutions, Correctional Services and Public Welfare	Review of the Community-Based Mental Retardation Program Management Summary	Touche Ross Kansas City office	January 20, 1975
27a. Appendices I, II, III, IV, and V to above.				
b. Appendices VI, VII, VIII and IX to above.				
c. Supplement to Appendix VII, Cost of Services Detail Schedules.				
28. Nevada	Nevada Public Service Commission	Southwest Gas Corporation Docket No. 241, rehearing	Thomas F. Doyle	March 26, 1976
29. Nevada	Nevada Public Service Commission	Continental Telephone Company of California Docket No. 64	Pat A. Loconto	April 3, 1975
29a. Exhibits to above.				

ATTACHMENT A - LIST OF TOUCHE ROSS & CO. TESTIMONY AND PRESENTATIONS ENCLOSED
(continued)

GOVERNMENTAL UNIT	DEPARTMENT/AGENCY	SUBJECT	WITNESS/AUTHOR	DATE
30. Nevada	Nevada Public Service Commission	Bell Telephone Company of Nevada	Pat A. Loconto	December 12, 1975
30a. Exhibit to above.				
31. Nevada	Nevada Public Service Commission	Field investigation Docket No. 425	Jeffrey D. Cropsey	December, 1975
32. Nevada	Nevada Public Service Commission	Rate base and operating income test year ended May 31, 1975 Docket No. 425	Kenneth M. Stevens	December, 1975
33. Nevada	Nevada Public Service Commission	Sierra Pacific Power Company Docket No. 183 Rate base and income statement	Testimony of Staff	May 15, 1975
33a. Exhibit to above.				
34. New Hampshire	Public Utilities Commission	In the matter of the petition of New England Telephone Company for approval of an increase in rates Docket No. DR 75-164	Donald J. Trawicki	November, 1975
35. New Jersey	Department of Public Utilities Board of Utility Commissioners	In the matter of the 1975 revision of rates filed by Elizabethtown Water Company, increasing its rates for water service Docket No. 757-769	Donald J. Trawicki Thomas E. Knudsen	September, 1975
36. New Jersey	Department of Public Utilities Board of Utility Commissioners	In the matter of the 1975 revision of rates filed by Elizabethtown Water Company, increasing its rates for water service Docket No. 757-769	Donald J. Trawicki	September, 1975
37. New Jersey	Department of Public Utilities	In the matter of the application of New Jersey Bell Telephone Company for approval of a certain agreement effective as of October 1, 1974, among New Jersey Bell Telephone Company, American Telephone and Telegraph Company and other Bell System Companies Docket No. 749-647	Donald J. Trawicki	November, 1975
38. New Jersey	Department of Public Utilities Board of Public Utility Commissioners	In the matter of the petition of New Jersey Natural Gas Company for approval of an increase in rates for gas services Docket No. 759-901	Thomas E. Knudsen	March, 1976
39. New Jersey	Department of Public Utilities	In the matter of the petition of Jersey Central Power and Light Company for approval of an increase in rates for electric service and for changes in the tariffs for such service Docket No. 759-899	Donald J. Trawicki	February, 1976
40. New Jersey	Department of Public Utilities	In the matter of proposed amendments to the Board's rules respecting discontinuance and deposits Docket No. 7411-803	Donald J. Trawicki	October, 1975

ATTACHMENT A - LIST OF TOUCHE ROSS & CO. TESTIMONY AND PRESENTATIONS ENCLOSED
(continued)

GOVERNMENTAL UNIT	DEPARTMENT/AGENCY	SUBJECT	WITNESS/AUTHOR	DATE
41. New Jersey	Department of Public Utilities	In the matter of the petition of Rockland Electric Company for approval of an increase in electric rates and for changes in its tariff Docket No. 7412-849	Donald J. Trawicki	July, 1975
42. New Jersey	Department of Public Utilities	In the matter of the petition of Atlantic City Electric Company for an increase in electric rates and for changes in its tariff Docket No. 758-842	Donald J. Trawicki	October, 1975
43. New Jersey	Department of Public Utilities	In the matter of the petition of Atlantic City Electric Company for an approval of an increase in rates for electric service Docket No. 748-640	Donald J. Trawicki	February, 1975
44. New Jersey	Department of Public Utilities	In the matter of the petition of Public Service Electric and Gas Co. for an increase in rates for electric and gas service Docket No. 744-335	Jamshed K. Madan	April, 1975
45. New Jersey	Department of Public Utilities	In the matter of the petition of New Jersey Bell Telephone Company for an increase in rates for telephone services Docket No. 747-522	Jamshed K. Madan	April, 1975
46. New Jersey	Department of Public Utilities	In the matter of the petition of Elizabethtown Gas Co. for approval of an increase in rates for gas service Docket No. 748-641	Donald J. Trawicki	February, 1975
47. New Jersey	New Jersey Commissioner of Insurance	Re Hospital Service Plan of New Jersey, Statement	Bernard Bachman	March 15, 1976
48. New Mexico	New Mexico Public Service Commission	Southern Union Gas Company	Pat A. Loconto	December, 1975
48a. Exhibit to above.				
49. North Carolina	Utilities Commission	In the matter of the application of Southern Bell Telephone Co. for an adjustment in its rates and charges applicable to Intrastate Telephone Service in North Carolina Docket No. P-55, Sub. 742	Donald J. Trawicki	
50. North Carolina	Utilities Commission	Special Report on Review of Internal Controls and Other Areas	Touche Ross Charlotte office	August 7, 1975
51. Ohio	Public Utilities Commission	In the matter of the application of the Cincinnati Gas and Electric Company for an increase in its electric rates in the City of Cincinnati and under the Direct Jurisdiction of the Utilities Commission of Ohio. Case Nos. 74-845-EL-AIR, 75-70-EL-AIR, Vol. I.	Pat A. Loconto	April 2, 1976

ATTACHMENT A - LIST OF TOUCHE ROSS & CO. TESTIMONY AND PRESENTATIONS ENCLOSED
(continued)

GOVERNMENTAL UNIT	DEPARTMENT/AGENCY	SUBJECT	WITNESS/AUTHOR	DATE
52. Ohio	Public Utilities Commission	Staff report of investigation	Touche Ross Cincinnati office	
53. Ohio	Public Utilities Commission	In the matter of the application of the Cincinnati Gas and Electric Company for an increase in its gas rates Docket No. 74 581-GA-AIR	Pat A. Loconto	March, 1976
54. Ohio	Public Utilities Commission	Staff report of investigation in the matter of the application of the East Ohio Gas Company for authority to modify and increase rates for natural gas to consumers in all territories served, except in Ashtabula and Lake counties and the cities of Akron and Canton Case No. 74-826-GA-AIR	Touche Ross Minneapolis office	March, 1976
55. Ohio	Public Utilities Commission	Statement of work for Phase II - Operations Improvement	Touche Ross Detroit office	
56. Tennessee	Tennessee Public Service Commission	United Inter-Mountain Telephone Company Docket No. U-6207	Pat A. Loconto	December, 1975
56a. Exhibit to above.				
57. Utah	Utah Public Service Commission	Utah Power and Light Company	Pat A. Loconto	January, 1976
57a. Exhibit to above.				
58. Vermont	Public Service Board	In the matter of the petition of Continental Telephone Company of Vermont for approval of an increase in rates P.S.B. - Case No. 3986	Donald J. Trawicki	December, 1975
59. Wyoming	Wyoming Public Service Commission	The Mountain States Telephone & Telegraph Company - rate base and operating income - test year ended September 30, 1975 Docket No. 9343 Sub. 5	Kenneth M. Stevens	November 13, 1975
59a. Exhibit to above.				
60. Wyoming	Wyoming Public Service Commission	The Mountain States Telephone & Telegraph Company Docket No. 9343 Sub. 4	Pat A. Loconto	March, 1975
60a. Exhibit to above.				
61. Virgin Islands	Public Services Commission	In the matter of the petition of Virgin Islands Water & Power Authority for an increase in electric rates Docket No. 106	Donald J. Trawicki	October, 1975

ATTACHMENT A LIST OF TOUCHE ROSS & CO. TESTIMONY AND PRESENTATIONS ENCLOSED
(continued)

GOVERNMENTAL UNIT	DEPARTMENT AGENCY	SUBJECT	WITNESS/AUTHOR	DATE
62. Virgin Islands	Public Services Commission	In the matter of the petition of Virgin Islands Telephone Corp. for an increase in rates for telephone services Docket No. 121	Jamshed K. Madan	September, 1975
63. Virgin Islands	Public Services Commission	In the matter of the petition of Virgin Islands Telephone Corp. for an increase in rates for telephone services Docket No. 121	Pat A. Loconto	September, 197[illegible]
64. U. S.	Cost Accounting Standards Board (Conference Rosemont, Illinois)	Presentation at Conference on Promulgated Standards and Regulations	Gerald E. Gorans	June 11, 1975

(Staff note: The enclosures from Touche Ross are retained in the committee files.)

ATTACHMENT B - LIST OF TOUCHE ROSS & CO. TESTIMONY AND PRESENTATIONS (COPIES NOT AVAILABLE)

GOVERNMENTAL UNIT	DEPARTMENT/AGENCY	SUBJECT	WITNESS/AUTHOR	DATE
Colorado	Department of Social Services	Financial and Medical Eligibility Report System Review	F. William Gilmore	April 12, 1976
Colorado	State Legislature	Report on letters of recommendation resulting from audits of Community Colleges	Milton W. Bollman	Annually
Minnesota	Minnesota Public Service Commission	Regulatory Training Program	Touche Ross Minnesota office	In process
Nevada	State Legislature - Committee on Utilities	Presentation re financing problems of utilities and various problems of public service commissions	Pat A. Loconto	March 13, 1975
Ohio	Ohio Public Utilities Commission	Staff reports re Madison Water Co. and Lorraine Telephone	Touche Ross Ohio office	In process
Texas	Texas Railroad Commission	Houston Pipeline	Pat A. Loconto	April 8, 1975
U. S.	Federal Communications Commission	American Telephone & Telegraph Co., The Associated Bell System Companies' charges for Interstate Telephone Services, Vol. 106, pp. 16591-16779	Pat A. Loconto	February 3, 1975

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Rel. No. 5459/February 25, 1974

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 10654/February 25, 1974

ACCOUNTING SERIES
Rel. No. 153/February 25, 1974

Admin. Proc. File No. 3-4437

IN THE MATTER OF :
:
TOUCHE ROSS & CO. :

FINDINGS, OPINION AND ORDER ACCEPTING WAIVER AND CONSENT AND IMPOSING REMEDIAL SANCTIONS

Information furnished to the Commission in a non-public investigation into the affairs and financial reporting of U. S. Financial, Inc. ("USF") 1/ for the period 1969 to 1972 indicated that financial reports issued by USF and filed with the Commission including the annual financial statements for the years ended 1970 and 1971 were false and misleading. Touche Ross & Co. ("Touche"), a partnership engaged in the practice of public accounting, certified the annual financial statements for those years.

It appears that as part of a scheme to mislead the public by publishing false financial statements reflecting fictitious earnings, USF and certain of its officers, directors and associates intentionally deceived Touche by making untrue representations and by furnishing false information in connection with its audits. The Commission has instituted legal proceedings against these parties. 2/

Any such deception, however, did not relieve Touche of its responsibility to perform its audits in conformity with generally accepted auditing standards. The information furnished to the Commission indicated that Touche's conduct of the 1970 and 1971 audits in a number of respects did not meet the professional standards required of public accountants who practice before the Commission.

Such information indicated that Touche failed to obtain sufficient independent evidentiary material to support its professional opinion in regard to a number of highly material transactions which were constructed by management in such a way as to make it appear that income had been earned when in fact it had not been. In connection with these transactions it also appeared that Touche failed to fully appraise the significance of information known to it and to extend sufficiently its auditing procedures

under conditions which called for great professional skepticism. These transactions resulted in USF improperly recognizing millions of dollars of revenues and profits in 1970 and 1971.

Touche has submitted to the Commission a waiver of the institution of formal administrative proceedings under Rule 2(e) and has consented to the entry of an order containing certain findings, conclusions and remedial sanctions.

Under the terms of Touche's waiver and consent, Touche, solely for the purpose of settlement of this matter, and without admitting or denying any violations, and without admitting or denying any fact except for the purposes of this settlement, consented, among other things, to the entry of an appropriate order.

After due consideration of the consent and upon the recommendation of our staff, we have determined that it is appropriate in the public interest to accept the consent.

The Commission believes that the responsibilities of independent public accountants are an essential part of our capital market system, which is based upon investor confidence in the reliability and fairness of financial statements. Any lack of diligence and professionalism on the part of independent auditors seriously erodes confidence in the financial reporting of public companies and tends to impair the functioning of the capital and trading markets with the result that our economy as a whole may suffer. By the acceptance of this consent, which includes the following findings describing the facts and auditing deficiencies discovered as a result of our staff investigation, the Commission hopes to reduce the likelihood of similar future cases. 3/

The 1970 Audit

In the 1970 audit, Touche permitted USF to record profit on two major transactions where the evidence available to Touche should have indicated that no profit in fact had been earned.

Burnham Management Corp.

On August 27, 1970, USF purportedly sold three properties to Burnham Management Corp. ("BMC") for $5,399,000 and recognized profit of $550,000 from the transaction. The letter agreement which covered the sale committed USF to use its best efforts to secure permanent financing on the properties for BMC and to pay certain underwriting costs upon BMC's syndication of the properties. Furthermore, the agreement provided that upon final documentation, which was not prepared and executed, USF was to deliver to BMC USF's guarantee that BMC would suffer no loss from operations of the properties. The agreement was also subject to an addendum which provided BMC with an absolute guarantee against loss from ownership

of the properties and a commitment by USF to complete construction of the properties. The terms of this agreement made the recognition of profit on the transaction improper in that as a result of the terms of the agreement and addendum USF had not shifted the risk of loss to BMC. 3a/

Shortly after year-end, BMC requested USF to take back the properties or find other buyers pursuant to a verbal "put" agreement entered into with BMC by Robert Walter ("Walter"), chief executive officer of USF. In response, USF "found" two buyers who were actually nominees of USF and one of whom assumed BMC's interest with funds provided by USF.

In connection with its review of the BMC transaction, Touche was aware that the final documentation was not prepared and executed. Although Touche was delivered a copy of the above addendum with a confirmation letter from BMC, Touche failed to examine or review the addendum. In addition, Touche did not pursue the implications of the post year-end disposition of the properties by BMC. On the basis of the information in its working papers, Touche should have refused to permit the recognition of profit on this transaction. Additional investigation would have developed further evidence as to the impropriety of the transaction.

Grubb & Ellis--Gribben

In late December 1970 a series of related agreements was entered into with Grubb & Ellis, Inc., an independent real estate enterprise, and with Walter P. Gribben ("Gribben"). Grubb & Ellis purchased certain properties from USF for $13.2 million, resulting in a book loss of $532,000 to USF. Grubb & Ellis prepaid $855,000 interest on this transaction which was treated as deferred income on USF's books. USF leased the properties back for two years and retained Grubb & Ellis to manage them for that period. At the same time, USF purportedly sold to Gribben, actually a USF nominee, its leasehold interest in the properties for $855,000 and recorded income in this amount. To cover Gribben's $855,000 check dated December 31, 1970, USF paid $855,000 to Gribben on January 4, 1971 allegedly to purchase Gribben's interest in the Grubb & Ellis management agreements which interest Gribben never owned.

Touche did not obtain documentation to warrant the inclusion in USF's financial statements of Gribben's purported purchase of the lease interest. No confirmation was obtained from Grubb & Ellis to support Gribben's purported ownership of the management agreements or his participation in the transaction. There was no confirmation from Gribben concerning his purported purchase of the lease. The only independent documentation supporting Gribben's purported purchase was his $855,000 check to USF. Touche was aware of but did not attach appropriate significance to USF's $855,000 payment to Gribben. Touche relied on a written representation of the principal financial officers of USF that Gribben was independent and on misleading explanations of Walter and John B. Halverson ("Halverson"), USF's executive vice president 4/, that the USF--Grubb & Ellis--Gribben transactions represented a complex

transaction meant to satisfy everyone's tax objectives (which objectives were unspecified) and constituted an inseparable unit not susceptible to separate analysis.

Had Touche penetrated this transaction rather than having placed reliance upon management's representations as to its purpose, the evolving pattern of manufacturing profits would have been evident at an earlier stage.

The 1971 Audit

Circumstances surrounding the commencement of Touche's 1971 audit of USF should have caused it to approach the audit with the highest degree of skepticism. In October 1971, at the time Touche was prepared to commence the audit, Touche was terminated by USF, which then engaged Haskins & Sells ("H&S"). On January 21, 1972, Walter terminated H&S 5/, and on the following day USF re-engaged Touche. In addition, Touche's experience on the 1970 audit indicated that USF was increasingly dependent on a relatively small number of large and complex transactions to achieve its income goals. It was also aware that management was aggressively seeking income to meet stated growth objectives.

In connection with the audit, Touche discovered that USF had structured a number of year-end transactions to give the appearance of income when in fact the income from these transactions could not properly be recognized in 1971. Touche required USF to defer $13 million of profits which reduced its previously calculated unaudited net income by nearly 60%.

The circumstances should have required Touche to extend substantially its auditing procedures in respect to the remaining transactions and to regard management representations with extreme care. Under such conditions, it is the Commission's view that Touche should have given closer consideration to criteria for revenue recognition including evidence of the purchaser's financial strength, effective control of the properties, control of the buyer by the seller and uncertainty as to the amount of costs to be incurred by the seller. While Touche did prepare a checklist with which to review USF's real estate transactions, the guidelines on the checklist, including a question regarding the source of funds received by USF from such transactions, were not consistently applied in evaluating the transactions.

Among the fraudulent real estate transactions on which USF improperly recognized revenue and profits in 1971 were the following:

Palm Springs Mobile Country Club ("PSMCC")

On March 26, 1971, USF sold PSMCC to National Community Builders ("NCB") for $5,750,000 in a "swap" transaction whereby USF also bought property from NCB. Because of the "swap," of which Touche was aware, USF could

not recognize the $1.9 million net profit realized on the sale in the first quarter of 1971. In an effort to perfect such profit, however, on April 13, 1971, USF caused NCB to sell PSMCC to TSL, Inc. ("TSL"),6/ a USF nominee of which Gribben was nominal owner, and USF then improperly recognized these revenues and profits in the second quarter of 1971.

TSL, on December 31, 1971, sold PSMCC to Carlsberg Resources Corp. ("Carlsberg") which had the right to "put" PSMCC back to TSL. At Carlsberg's insistence, USF guaranteed TSL's performance under the agreement. Carlsberg had 120 days to examine the PSMCC property and books and decide whether to put the property back to TSL. In a separate agreement, USF agreed to guarantee Carlsberg a cash flow of $105,000 per annum on the property in the event the put was not exercised.

It is the Commission's view that Touche should have determined from the evidence available that TSL was in fact a nominee of USF without independent economic substance.7/ Such a determination would have led to the conclusion that no profit should have been realized on the transaction since a put option to TSL remained outstanding on the property at the date the auditor's opinion was signed.8/

<u>Coastal Land Corporation ("CLC")</u>

On December 27, 1971 USF sold certain mobile home parks to CLC for approximately $19.2 million, receiving approximately $1.9 million cash and the remainder in long-term notes. USF improperly recognized approximately $3 million in profit in 1971 from the sale. USF had acquired the parks from Boise Cascade Corp. ("Boise") in September 1971 purportedly "in-trust" for CLC pursuant to a September 10, 1971 agreement between CLC and USF which was contingent upon closing prior to year-end 1971. On November 24, 1971 USF and CLC purportedly rescinded the September 10 agreement (but for one park which was syndicated to certain of USF's officers and directors) because of CLC's purported inability to obtain the cash down payment.9/

CLC thereafter obtained the requisite $1.9 million cash down payment through a loan in that amount from Union Bank of California, San Diego. The loan was nominally guaranteed by Bayview Investments ("BI"), a Walter nominee, but was actually secured by Walter's pledge of 80,000 shares of USF stock.

In connection with Touche's audit of the CLC transaction, Touche made extensive inquiries as to the source of CLC's $1.9 million down payment because of the following concerns Touche had regarding CLC's affiliates' other transactions with USF: that CLC was owned by Richard W. Arneson, Jr., ("Arneson"); that Arneson together with Dennis P. Hill ("Hill") were the nominal owners of A-H Properties ("A-H"), which entity was indebted to USF as of November 1971 in the amount of approximately $15.2 million and was in default on such debt; that A-H and USF were involved in a $4.5 million sale and lease-back transaction whereby A-H sold to and leased-back from USF the land underlying certain A-H properties in December 1971[10/] to partially fund the elimination of A-H's delinquent secured debt and certain unsecured "advances" from USF; and that USF had given A-H a guarantee against loss from operations and other expenses until 80% occupancy was reached on the properties, which had not been accomplished as of the 1971 audit.

Because of Touche's concern that CLC's down payment might have been funded indirectly by USF through A-H, Touche determined that Union Bank had loaned the funds to CLC, and that the loan was guaranteed by an unnamed corporation (BI) which purportedly used its undisclosed credit sources to support the guarantee. A Touche representative stated during the Commission's investigation that Touche's concurrence with the recordation of the profits "realized" from the transaction was conditioned on a negative determination of "no direct or indirect involvement" in the CLC loan by USF, its officers or directors.

Touche requested from USF certain financial information concerning CLC and A-H but was informed by Walter that such information was not available. Touche did not contact Union Bank to inquire whether USF or any of USF's officers or directors were directly or indirectly involved in the CLC loan. Touche requested from Arneson a representation that USF and its affiliated persons were not "directly or indirectly involved." Arneson stated in a written representation that USF's officers "were not directly involved." While Arneson failed to disclaim in writing any indirect involvement, Touche's representative felt assured from his concurrent conversation with Arneson that there was also no indirect involvement. Touche received a representation letter from counsel to the unnamed corporate guarantor of the CLC loan (BI) which stated that the unnamed corporation had undisclosed beneficial owners (who were in fact Arneson and Hill) whom counsel refused to identify to Touche, and that the corporation used its credit sources as a basis for its guaranty, which credit sources were not identified. Touche further received from Walter an intentionally false and misleading written representation intended to deceive Touche that "neither USF...nor

any affiliated persons have guaranteed, either directly or indirectly any obligation of CLC." Touche relied upon the above representations and concurred in USF's profit recognition from the CLC transaction.

It is the view of the Commission that had Touche's confirmation procedures included a direct inquiry to Union Bank and had Touche insisted upon knowing the identity of the corporate guarantor, it is likely that Walter's involvement in the loan would have come to light--despite Walter's express representations to the contrary.

Relationship with Predecessor Auditors

As previously noted, Touche succeeded H&S in the 1971 audit. During the course of Touche's audit it reviewed some of H&S's work papers prepared during the course of the latter's brief engagement, but in the view of the Commission communication between the firms was not as complete as it should have been. When one auditor succeeds another, be it on the same engagement or on a different one, it is important that the successor obtain access to and carefully review the results of the predecessor's work. In most instances, this will entail some review of the predecessor's work papers. In other instances, it may require discussions with those responsible for the predecessor's work. If a client refuses to permit such discussions, such a refusal should constitute a reason for rejecting the engagement. It is essential that both the successor and the predecessor be fully advised of the reasons surrounding the termination and the new engagement, of any questions raised or problems encountered in the audit by the terminated firm, and of any other relevant circumstances, so that the public interest that the accounting profession is supposed to protect will be properly served. No one's interests are served by one independent accountant not revealing information known to it which may bear upon the work of another independent accountant who is examining financial statements which are destined to be disseminated to the public or filed with the Commission. As the Commission has previously pointed out, the public accountant's first duty is to safeguard the public interest, not that of his client. 10a/

Summary

While it appears that Touche was deliberately misled in many respects by USF's management in the course of the 1970 and 1971 audits, Touche's failure in a number of respects to conduct these engagements in accordance with generally accepted auditing standards makes Touche responsible for certifying financial statements which proved to be materially false and misleading. 11/ As the Commission stated in its report on McKesson & Robbins, Inc.: 12/

> ". . . We believe that . . . [with respect to] examinations for corporations whose securities are held by the public, accountants can be expected to detect gross overstatements of assets and profits, whether

> resulting from fraud or otherwise. We believe that alertness on the part of the entire [audit] staff, coupled with intelligent analysis by experienced accountants of the manner of doing business, should detect overstatements in the accounts, regardless of their cause, long before they assume the magnitude reached in this case. Furthermore, an examination of this kind should not, in our opinion, exclude the highest officers of the corporation from its appraisal of the manner in which the business under review is conducted. . . . [W]e feel that the discovery of gross overstatements in the accounts is a major purpose of. . .an audit. . . ."

Although Touche's San Diego, California, office was primarily responsible for the audits in question, Touche partners from other offices, including the national office, also participated in and were consulted with respect to certain aspects of the audits. They also planned and supervised a review of certain USF audit programs and working papers, as well as the findings, conclusions and accounting principles to be followed. While every firm is responsible for the opinions issued by any of its partners, the involvement in this case of other partners and offices of Touche, as is cusomary and expected of a national accounting firm, emphasizes that the firm as a whole must share the responsibility.

In accepting the offer of settlement, the Commission has considered the fact that Touche, with one exception noted below, has not previously been subject to disciplinary or enforcement proceedings instituted by the Commission and that the one exception 13/ arose out of conduct which occurred in connection with financial statements for the year 1947. In accepting Touche's undertaking to adopt certain procedures to strengthen its existing ones, the Commission does not contemplate that they will encompass steps which are other than required by generally accepted auditing standards. Rather, Touche and the Commission contemplate that these procedures will improve Touche's ability to carry out its responsibility to exercise due professional care in the conduct of its future engagements. While we do not believe that any form of procedure can ever be a substitute for the kind of healthy skepticism which a good audit requires, we anticipate that these procedures will materially aid in the performance of the firm's responsibility. 14/ In this connection, our order will specifically direct Touche to strengthen its procedures so that all future audit engagements will include a specific review to determine any private involvement of the management and other related persons in corporate transactions reflected in financial statements under examination. Fundamental to financial reporting is the assumption that financial statements reflect the results of arm's-length bargaining between independent parties. The presence of transactions between affiliates inevitably raises questions as to the meaningfulness of the resulting information. Further, as is apparent in this case, it should raise broader questions as to the reliability and completeness of the information being provided. It is for this reason, among others, that the

Commission has long required that transactions which involve persons related to the management of a filing corporation be specifically disclosed to the Commission and public investors. 15/

In reviewing significant transactions, it is not enough for auditors to accumulate documents relating to the transactions. It is critical that an analysis be made of transactions and all of their ramifications, including any involvement management or persons acting for management may have in such transactions. It is equally insufficient to obtain negative assurances that no such involvement is present if at the same time all of the details are not known as to the various transactions in question. Thus, for example, when an accountant becomes aware that a party to a transaction has received a guarantee or some other form of assurance which may relieve him of some risk of loss, it is critical that the accountant not only receive assurances that such guarantee does not involve members of management, but also that he obtain information concerning the nature and extent of the guarantee, as well as the identity of the guarantor. It is only when armed with that information that the accountant may properly evaluate whether or not the transaction, including the guarantee, will be properly reported.

In view of the above findings, the Commission concludes that Touche engaged in improper professional conduct.

* * * * *

Under the terms of its offer of settlement, Touche, without admitting or denying the Commission's findings and solely for the purpose of settlement, consented to the entry of an order embodying the following sanctions.

Accordingly, IT IS ORDERED that proceeedings pursuant to Rule 2(e) of the Commission's Rules of Practice be, and they hereby are, instituted against Touche Ross & Co.

IT IS FURTHER ORDERED that, subject to the terms and conditions provided in the offer of settlement Touche Ross & Co., be, and it hereby is:

A. Censured by the Commission.

B. Required to adopt, maintain and comply with procedures which shall be submitted to the Commission for its review and approval within thirty (30) days after the date hereof, to prevent future violations of the federal securities laws, which procedures shall provide, among other things, as a means of strengthening Touche's procedures

1) That in all audit engagements specific review shall be made which is designed to determine the management's direct or indirect involvement in material transactions which are included in the financial statements;

2) For the formulation and implementation of qualitative office review procedures requiring periodic review at least once every two years of all Touche offices under the control and supervision of Touche's national staff to evaluate and ensure the quality of the audit engagements of such offices.

C. In order to ascertain that Touche is conducting its professional practice in compliance with paragraph B above, an investigation, which shall be conducted at the expense of Touche, shall be conducted by the Commission in accordance with methods and procedures adopted or approved by it by the use of members of the profession in public practice selected or approved by the Chief Accountant of the Commission or, at its option, by use of qualified professional accountants drawn from its own staff. Provided, however, that in those instances where persons conducting the aforesaid investigation are not members of the Commission's staff such persons (who shall be given a copy of these Findings, Opinion and Order and Consent) shall hold in confidence the fact that such persons are engaged in such investigation as well as all information, books, papers, records, documents or other materials obtained and/or utilized during the course of such investigation and relating to the clients, procedures, systems or methods of Touche. The report of investigation, in those instances where the investigation is conducted by persons other than members of the Commission's staff, shall be submitted to the Commission only and shall be the sole property of the Commission and shall be maintained in the Commission's non-public investigative files. Nothing herein is intended in any way to alter or amend the powers or jurisdiction of the Commission.

D. For a period of twelve (12) months after the date of this order, Touche's San Diego, California, branch office will not accept or undertake any new professional engagement which can be expected to result, within twelve (12) months from the date of such engagement, in filings, submissions or certifications with the Commission. For the purpose of such offer of settlement, "new professional engagement" is defined to mean an engagement entered into after five (5) days subsequent to the effective date of this order between Touche's San Diego, California, branch office and any person or corporation subject to the disclosure requirements of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Trust Indenture Act of 1939 and the Public Utility Holding Company Act of 1935. Nothing herein shall be construed to affect the right or obligation of Touche's San Diego, California, branch office during this twelve (12) month period to perform its normal functions and services for existing clients (including activities requiring filings, submissions or certifications with the Commission), or to undertake engagements for new clients which cannot be expected to result, within twelve (12) months from the date of such engagement, in filings, submissions or certifications with the Commission.

E. Touche will not accept or undertake any new professional engagement of any client whose business, revenues and net profit (loss) is materially derived from real estate development or sales, including financing related thereto, as defined herein, which engagement can be expected to result, within twelve (12) months from the date of such engagement, in filings, submissions, or certifications with the Commission until the Chief Accountant of the Commission is satisfied that adequate audit guides and programs for application have been adopted, including appropriate testing thereof as applied to audits. For the purposes of such offer of settlement, "new professional engagement" is defined to mean an engagement entered into after five (5) days subsequent to the effective date of this order between Touche and any person or corporation subject to the disclosure requirements of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Trust Indenture Act of 1939 and the Public Utility Holding Company of 1935. For the purposes of such offer of settlement, "any client whose business revenues and/or net profit (loss) is materially derived from real estate development, or sales, including financing related thereto," is defined to mean any client at least twenty-five (25) percent of whose gross revenues or pre-tax net profits (losses) were derived from real estate development or sales, including financing related thereto, within two (2) of the preceding three (3) fiscal years. Nothing herein shall be construed to affect the right or obligation of Touche during this twelve (12) month period to perform its normal functions and services for existing clients (including activities requiring filings, submissions or certifications with the Commission), or to undertake engagements for new clients which cannot be expected to result, within twelve (12) months from the date of such engagement, in filings, submissions or certifications with the Commission.

F. The Commission shall retain jurisdiction of this matter pending final receipt of a report of investigation referred to in paragraph C above and thereafter for either the taking, if necessary, of appropriate action to ensure compliance, including but not limited to the re-opening of these proceedings for the imposition of such other and further relief as may be required under the circumstances, or the approval of the report and termination, on notice, of this proceeding.

By the Commission (Commissioner Pollack not participating).

George A. Fitzsimmons
Secretary

FOOTNOTES

1/ Prior to 1969, USF was engaged in the development, construction and sale of single family residential homes and home sites. During 1969, 1970 and 1971, USF's reported income was derived primarily from real estate financing and the development and sale of multiple family and commercial real estate projects. USF's common stock was listed on the New York Stock Exchange on December 29, 1970 and was delisted on December 10, 1973.

2/ Securities and Exchange Commission v. U. S. Financial, Inc., et al., 74 Civil 92-S (S.D.Cal., February 25, 1974).

3/ Our findings are not binding upon any other persons against whom proceedings may be brought as a result of the investigation.

3a/ See Accounting Series Release No. 95, December 28, 1962.

4/ In December 1971, Halverson became USF's president and chief operating officer.

5/ A report of USF's Audit Committee submitted to the Board of USF in mid-February 1972 stated: "2. The January 1972 termination of HS was motivated in part by the inability of HS to complete the 1971 audit by the end of February, in part by an incompatibility which developed between management and HS and in part by potential disagreements as to matters of accounting principles. 3. The potential disagreements as to accounting principles between the management of USF and HS involved the question of when income should be recognized by USF in the following types of transactions: (a) Commissions, fees, and financing-type income received in cash by USF in 1971 from joint ventures or partnerships in which USF had an interest, where the cash received by USF came out of moneys loaned by USF. (b) Gains, profits and commissions income received by USF in 1971 where USF's profit or gain was represented at the end of 1971 by notes rather than cash, or where USF had a continuing cash investment in the transaction or had a contingent obligation to supply funds." Touche received a copy of the Audit Committee Report shortly thereafter.

6/ USF could direct NCB to sell PSMCC to a buyer chosen by USF for the same sales price of $5,750,000 pursuant to the March 26, 1971 sales agreement.

7/ Touche knew that a $375,000 note given by TSL to NCB as part of TSL's down payment for the purchase of PSMCC was paid with a $375,000 advance by Walter to TSL, that the stock of PSMCC secured TSL's debt to USF, assumed from NCB in connection with TSL's purported purchase, that under a management agreement USF was obligated to pay all operating expenses of PSMCC, and that TSL assumed BMC's "interest" in two of the three properties purportedly sold to BMC as described above. Touche also had in its possession TSL's unaudited balance sheet as of December 31, 1971, which showed that all of TSL's assets were acquired from USF and all of TSL's liabilities were owed to USF. Touche did not obtain TSL's income statement.

8/ In any event, Touche did not contact Carlsberg to determine the likelihood of the "put" being exercised but relied upon Walter's representation that exercise of the "put" was highly unlikely after April 15, 1972. Touche issued its certificate on April 21, 1972, at about the same time that Carlsberg indicated its intention to put PSMCC to TSL.

9/ The November 24 rescission letter was a fiction created by Walter at year-end and back dated to support Walter's claim that USF be allowed to recognize the $1 million commission paid USF by Boise in connection with the transaction as income rather than a reduction in cost basis, which sum USF improperly recognized in the third quarter of 1971, and that USF be allowed to recognize an additional $3 million in sale income as a result of the December 27, 1971 purported resale to CLC.

10/ The properties were sold to Equity Investment Corp., predecessor of A-H, a 35%-owned USF affiliate, on December 31, 1969. Arneson and Hill purportedly purchased Equity Investment Corp. from that company's stockholders in April 1970.

10a/ See, *e.g.*, *In the Matter of McKesson & Robbins, Inc.*, Accounting Series Release No. 19 (1940).

11/ As stated in the AICPA's recently issued Statement on Auditing Standards §110.05 (1973), which was substantially a restatement of existing practice, in making an ordinary examination, the auditor must be alert to and recognize "the possibility that fraud may exist" and that fraud, "if sufficiently material, may affect his opinion on the financial statements. . . ." Accordingly, "his examination, made in accordance with generally accepted auditing standards, gives consideration to this possibility," even though the ordinary examination is not "primarily or specifically designed" to detect fraud. The failure, therefore, to conduct an examination in accordance with generally accepted auditing standards means that the auditor is responsible for his failure to detect fraud when such failure results from a departure from auditing standards.

12/ In the Matter of McKesson & Robbins, Inc., Accounting Series Release No. 19 (1940).

13/ In the Matter of Touche, Niven, Bailey & Smart, 37 S.E.C. 629 (1957).

14/ "Due professional care" requires the exercise of a "critical review at every level of supervision of the work done and the judgment exercised by those assisting in the examination." AICPA Statement on Auditing Standards, supra §230.02. As previously described in the CPA Handbook,

> "On the negative side of care there is the avoidance of negligence and the kind of laziness that is satisfied with a task only partly done or performed by rote in a reverie more appropriate to an assembly bench than to an audit examination. On the positive side there are the requirements that each person engaged in an examination must be aware of the purpose of what he is doing, must understand and perform with mental alertness, inquisitiveness, and a sense of responsibility, even those tasks which may appear to be routine, and must respond diligently by further inquiries or examinations to circumstances indicating them to be necessary. The auditor should carry out his examination with an attitude of healthy skepticism which seeks corroboration of explanations offered for matters that have aroused questions in his mind, particularly when those explanations come from persons who could have personal reasons for diverting further inquiry. Care is required even when personal acquaintanceship with the client or its employees and their unquestioned reputation in the community for the highest standards of righteousness and probity, may appear to justify complete reliance on them. In such cases it is desirable to keep three facts in mind:
>
> 1. An independent examination is a check on representations of management however honest and competent that management may be, and reliance on managerial virtues is not a check.
>
> 2. Banks sometimes make character loans, but there is no such thing as a character audit.
>
> 3. Defalcations are nearly always perpetrated by old and trusted employees of good reputation."

Wilcox, "Professional Standards," CPA Handbook, Vol. I, Chapter 13, pp. 11-12 (American Institute of Accountants, 1952).

15/ See, for example, Item 20 of Form S-1, requiring disclosure of the interests of management and others in certain corporate transactions.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 12851 / October 1, 1976

In the Matter of

TOUCHE ROSS & COMPANY
EDWIN HEFT
JAMES M. LYNCH
ARMIN J. FRANKEL

On September 2, 1976, the Securities and Exchange Commission ordered public administrative proceedings pursuant to Rule 2(e) of the Commission's Rules of Practice against Touche Ross & Company ("Touche"), a partnership engaged in the practice of public accounting; Edwin Heft, a Certified Public Accountant and an Associate National Director of Accounting and Auditing for, and a senior partner in Touche during its audit of the financial statements of Giant Stores Corp. ("Giant") for the fiscal year ended 1972 ("1972 financial statements"); James M. Lynch, a Certified Public Accountant and a partner in Touche's Boston office during the audit of Giant's 1972 financial statements; and Armin J. Frankel a Certified Public Accountant and a partner in Touche's Boston office during the audit of Giant's financial statements (herein collectively referred to as "Respondents").

The proceedings are based upon allegations of the Commission's staff that Respondents have engaged in improper professional conduct and have willfully violated and aided and abetted violations of Sections 5, 7, 10 and 17(a) of the Securities Act, Sections 10(b) and 13 of the Exchange Act, and rules and regulations promulgated thereunder, including Regulation S-X.

The allegations against the Respondents arise from Touche's audit of Giant's 1972 financial statements. Additional allegations against Touche arise from Touche's audit of Ampex Corporation's financial statements for the fiscal year ending January 29, 1972.

ADMINISTRATIVE PROCEEDING
FILE No. 3- 5075

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of TOUCHE ROSS & COMPANY EDWIN HEFT JAMES M. LYNCH ARMIN J. FRANKEL	ORDER FOR PUBLIC PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO RULE 2(e) OF THE COMMISSION'S RULES OF PRACTICE

I

The Office of the Chief Accountant alleges that:

1. Respondent Touche Ross & Company ("Touche"), is a partnership engaged in the practice of public accountancy, with its principal offices in New York, New York.

2. Respondent Edwin Heft ("Heft") is a Certified Public Accountant, and at all times relevant to the Giant Stores Corp. ("Giant") engagement referred to herein, he was an Associate National Director of Accounting and Auditing for, and a senior partner in Touche and represented Touche in the Giant engagement.

3. Respondent James M. Lynch ("Lynch") is a Certified Public Accountant and, at all times relevant to the Giant engagement referred to herein, was a partner in the Boston office of Touche and represented Touche in the Giant engagement.

4. Respondent Armin J. Frankel ("Frankel") is a Certified Public Accountant, and at all times relevant to the Giant engagement referred to herein, he was a partner in the Boston Office of Touche and represented Touche in the Giant engagement.

5. Respondents Touche, Heft, Lynch and Frankel have appeared and practiced, and Touche, Lynch and Frankel continue to appear and practice before the Commission.

6. Touche examined and reported on the financial statements of Giant, including a Consolidated Balance Sheet, related Consolidated Statements of Earnings and related Consolidated Statements of Stockholders Equity and Changes in

Financial Position, for the fiscal year ending January 29, 1972 ("1972 financial statements"), which report ("April 18, 1972 Report") was withdrawn by Touche on or about April 1973. The 1972 financial statements were included in Giant's registration statement on Form S-1 declared effective by the Commission on August 24, 1972 and Annual Report on Form 10-K filed with the Commission on April 28, 1972.

7. Touche examined and reported on the financial statements of Ampex Corporation ("Ampex") including a Consolidated Balance Sheet, related Consolidated Statements of Net Earnings and Shareowner's Equity, and the related Consolidated Statement of Changes in Financial Position, for the fiscal year ending May 1, 1971 ("1971 financial statements"), which report ("June 21, 1971 Report") was withdrawn by Touche on or about June 30, 1972. The 1971 financial statements were included in Ampex's Annual Report on Form 10-K filed with the Commission on August 3, 1971.

The Giant Engagement

8. In its April 18, 1972 Report, referred to in paragraph 6 above, Touche represents that its examination of the 1972 financial statements were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as were considered necessary in the circumstances; and gives its opinion that the 1972 financial statements present fairly the consolidated financial position of Giant and wholly owned subsidiaries at January 29, 1972, the results of its operations, and changes in financial position, all in conformity with generally accepted accounting principles.

9. The April 18, 1972 Report of Touche is materially false and misleading in that the examination of the 1972 financial statements was not made in accordance with generally accepted auditing standards and did not include such tests of the accounting records and such other auditing procedures as were necessary in the circumstances. Further, Touche did not have a reasonable basis for opining that the 1972 financial statements presented fairly the consolidated financial position of Giant and wholly-owned subsidiaries at January 29, 1972, the results of its operations, or changes in financial position, all in conformity with generally accepted accounting principles, for the reasons set forth in paragraphs 10 and 11 below.

10. In its 1972 financial statements, Giant materially overstated net income, as a result of, among other things:

(a) Recording fictitious credits from outside suppliers totalling approximately $1,041,000; and

(b) Failing to record an accounts payable accrual in the amount of approximately $1,400,000 and substituting a much smaller accrual, which resulted in the material understatement of accounts payable.

11. In performing the examination of the Giant's 1972 financial statements referred to in paragraphs 6, 8, 9 and 10 above, Touche, Heft, Lynch and Frankel (sometimes hereinafter referred to as "the Respondents") failed to follow generally accepted auditing standards, permitted the use of accounting principles which were not in accordance with generally accepted accounting principles and did not have a reasonable basis for the expression of an unqualified opinion on Giant's financial statements, in that, among other things, the Respondents:

(a) Accepted theories and accounting entries which were contrary to generally accepted accounting principles, such as, the improper recording of certain credits by Giant in the fiscal year ended January 29, 1972, on the basis of Giant's claim that it could obtain such credits in the future after negotiations with suppliers.

(b) Accepted the recording of certain items, without performing adequate auditing procedures with respect thereto and without a reasonable basis for such acceptance.

(c) Accepted inconsistent representations and contradictory explanations by Giant management as to the basis and reasons for certain items, which explanations were unreasonable under the circumstances and were contrary to other information possessed by Touche.

(d) Overruled the conclusions of certain members of Touche's audit staff without a reasonable basis and continually placed excessive reliance on the representations of Giant management despite, among other things, the warnings of certain members of the Touche audit staff as to the suspect credibility of Giant management and the matters discussed in paragraph 11(c) above.

(e) Failed to obtain proper and sufficient confirmations or to follow sufficient alternative procedures to support the recording by Giant of certain items, and disregarded contrary information in its possession. These deficiencies are evidenced by, among other things:

(1) Acceptance of the validity of significant credits despite the denial by a supplier of the factual basis for certain of the credits and refusal to provide a written confirmation with respect to the credits;

(2) The use of telephone confirmation procedures, which did not permit Touche to communicate with the suppliers independently of Giant's management and which did not enable the Touche audit staff to verify the identity of the persons who were purporting to be confirming the items; and

(3) The acceptance of a telephone confirmation from one supplier and three documents as the basis for the support of approximately 1,100 purported advertising credits when such credits were questionable on their face and so recognized by the Touche audit staff, and the three documents were inconsistent with the purported credits;

(f) Disregarded evidence obtained by Touche's audit staff, including the results of an audit test conducted to determine if invoices were recorded in the correct fiscal year; which results revealed an initial error rate of approximately 36%, and projections by the Touche audit staff which indicated that a material adjustment to accounts payable was necessary.

(g) Disregarded or failed to adequately respond to numerous facts and circumstances which raised questions as to the credibility of Giant's management and the propriety of the recording by Giant of certain items, including:

(1) The introduction of, at a very late date during the audit and in a highly suspicious manner, new items which, if recorded in the fiscal year ending January 29, 1972, would materially increase reported net income for that period;

(2) The determination of Giant management to reach a predetermined net income figure;

(3) Giant management's efforts to threaten and intimidate the Touche audit staff; and

(4) The refusal and reluctance of Giant management to furnish information or permit adequate audit procedures to be followed.

(h) Negotiated with Giant management the dollar amount of certain items to be recorded, including the allowance for bad debts and an accounts payable accrual. The amounts agreed upon were arbitrarily determined, were without any reasonable basis or support, and were materially at variance with evidence developed by the Touche audit staff.

The Ampex Engagement

12. In its June 21, 1971 Report, referred to in paragraph 7 above, Touche represents that its examination of the 1971 financial statements of Ampex were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as were considered necessary in the circumstances; and gives its opinion that the 1971 financial statements present fairly the financial position of Ampex and subsidiaries at May 1, 1971, the results of their operations, and changes in financial position, all in conformity with generally accepted accounting principles.

13. The June 21, 1971 report is materially false and misleading in that the examination of the 1971 financial statements were not in accordance with generally accepted auditing standards and did not include such tests of the accounting records and such other auditing procedures as were necessary under the circumstances. Further, Touche did not have a reasonable basis for opining that the 1971 financial statements present fairly the financial position of Ampex and subsidiaries on May 1, 1971, the results of their operations, and changes in financial position, all in conformity with generally accepted accounting principles, as described in paragraph 14 below.

14. The 1971 financial statements and the June 21, 1971 Report with respect thereto, each failed to reflect the following:

(a) The allowance for doubtful accounts receivable as it appeared on the Consolidated Balance Sheet of Ampex as of May 1, 1971 was substantially understated. Touche knew that a significant adjustment

was needed to increase the allowance for doubtful accounts. However, Touche waived its proposed adjustment, and in lieu thereof accepted the contentions of Ampex management that the books of account contained an aggregate similar amount, consisting of "hidden reserves" unrelated to accounts receivable, which would serve to "offset" the proposed adjustment. Touche did not obtain sufficient competent evidential matter to corroborate these contentions of Ampex management. Neither did Touche obtain sufficient competent evidential matter to afford a reasonable basis for concluding that the allowance for doubtful accounts was fairly stated. In addition, the accounting treatment adopted by Touche, irrespective of the alleged "offset", was incorrect and misleading.

(b) Touche ascertained that as of May 1, 1971, current royalty payment commitments arising out of minimum guarantee provisions of licensing agreements, not recoverable from tape sale revenues, approximated $10 to $15 million. This would have represented an additional fiscal 1971 cost of Ampex. Touche and Ampex, through negotiation of a "trade off", arrived at a 1971 addition of only $5 million to the then existing provision of $1 million. Touche did not obtain sufficient competent evidential matter to afford a reasonable basis to support the fairness of the $6 million provision in lieu of the documented $10 to $15 million estimate. In addition, the resulting effect on the financial statement was misleading, since the "trade-off" involved accounting matters unrelated to royalty payments; and

(c) In addition to the inadequate provision for losses arising out of minimum guarantee provisions of licensing agreements described in paragraph 13(b) above, the Music Division of Ampex had on May 1, 1971 firm obligations to pay approximately $80 million in royalties to various music companies in years subsequent to fiscal 1971. These payments arising out of the minimum guarantee provisions of licensing agreements were payable whether or not Ampex sold any pre-recorded music tapes made under the licensing agreements. Furthermore, certain of these licensing agreements contained open-ended provisions requiring Ampex to make royalty payments to the record company licensors

based on record company sales over which Ampex had no control. Disclosure of these significant contingent liabilities was required.

II

The allegations set forth in Section I hereof, if true, tend to show that Touche, Heft, Lynch and Frankel have engaged in improper professional conduct and have willfully violated and aided and abetted violations of Sections 5, 7, 10, and 17(a) of the Securities Act, Sections 10(b) and 13 of the Exchange Act, and the rules and regulations promulgated thereunder including Regulation S-X.

III

In view of the allegations set forth in Section I hereof, the Commission deems it necessary and appropriate in the public interest that a public proceeding be instituted pursuant to Rule 2(e) of the Commission's Rules of Practice to determine:

(a) Whether such allegations are true and in connection therewith to afford respondents an opportunity to establish any defense to such allegations; and

(b) Whether respondents should be temporarily or permanently disqualified from and denied the privilege of appearing or practicing before the Commission or whether such other relief as may be determined by law should issue.

IV

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof be held pursuant to Rule 2(e) of the Commission's Rules of Practice at a time and place to be fixed, and before a hearing officer to be designated; by further order as provided by Rule 6 of the Commission's Rules of Practice.

IT IS FURTHER ORDERED that respondents shall file an answer to the allegations set forth in Section I hereof within 15 days after service upon said respondents of this order for proceedings as provided by Rule 7 of the Commission's Rules of Practice.

If any respondent fails to file the directed answer or fails to appear at a hearing of which said respondent has been duly notified, said respondent shall be deemed in default and

the proceeding may be determined against said respondent upon consideration of the order for proceedings, the allegations of which may be deemed to be true.

This order shall be served upon respondents personally by certified mail forthwith.

By the Commission.

George A. Fitzsimmons

Secretary

SERVICE LIST

Rule 23 of the Commission's Rules of Practice provides that all amendments to moving papers, all answers, all motions or applications made in the course of a proceeding (unless made orally during a hearing), all proposed findings and conclusions, all petitions for review of any initial decision, and all briefs shall be filed with the Commission and shall be served upon all other parties to the proceedings including the interested Division of the Commission.

The attached Order for Proceedings has been sent to the following parties:

Securities and Exchange Commission
500 North Capitol Street N.W.
Washington, D.C. 20549

Securities and Exchange Commission
Office of Chief Accountant
500 North Capitol Street N.W.
Washington, D.C. 20549

Securities and Exchange Commission
Division of Enforcement
500 North Capitol Street N.W.
Washington, D.C. 20549

Chief Administrative Law Judge
Securities and Exchange Commission
1100 L Street N.W.
Washington, D.C. 20005

Touche Ross & Company
1633 Broadway
New York, New York 10019

James M. Lynch
360 School Street
Belmont, Massachusetts

Edwin Heft
920 Broadway
Woodmere, New York

Armin J. Frankel
47 Rita Road
Braintree, Massachusetts 02184

APPENDIX D—COMPENSATION OF PRINCIPAL EXECUTIVES AND NUMBER OF WOMEN AND BLACK PARTNERS IN "BIG EIGHT" FIRMS

ABRAHAM RIBICOFF, CONN., CHAIRMAN

JOHN L. MC CLELLAN, ARK.
HENRY M. JACKSON, WASH.
EDMUND S. MUSKIE, MAINE
LEE METCALF, MONT.
JAMES B. ALLEN, ALA.
LAWTON CHILES, FLA.
SAM NUNN, GA.
JOHN GLENN, OHIO

CHARLES H. PERCY, ILL.
JACOB K. JAVITS, N.Y.
WILLIAM V. ROTH, JR., DEL.
BILL BROCK, TENN.
LOWELL P. WEICKER, JR., CONN.

RICHARD A. WEGMAN
CHIEF COUNSEL AND STAFF DIRECTOR

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

SUBCOMMITTEE:
LEE METCALF, MONT., CHAIRMAN

JOHN L. MC CLELLAN, ARK.
EDMUND S. MUSKIE, MAINE
SAM NUNN, GA.
JOHN GLENN, OHIO

BILL BROCK, TENN.
CHARLES H. PERCY, ILL.
LOWELL P. WEICKER, JR., CONN.

VIC REINEMER, STAFF DIRECTOR
E. WINSLOW TURNER, CHIEF COUNSEL
161 RUSSELL BUILDING

(202) 224-1474

7 June, 1976

(Staff note: The same letter was sent to other "Big Eight" firms.)

Mr. Walter Hanson
Managing Partner
Peat, Marwick, Mitchell & Company
345 Park Avenue
New York, New York 10022

Dear Mr. Hanson:

The 10 May, 1976 issue of Business Week included its annual survey of executive compensation. The Business Week Survey -- prepared for the second straight year with the assistance of Peat, Marwick, Mitchell & Company -- showed the total compensation received by the top three executives of many large corporations. Because the corporations are publicly held, information on compensation may be obtained from proxy materials, annual reports and other sources.

Similar information is not available on the total compensation earned by the top executives of major accounting firms, even though they have revenues, income, and economic impact equal to many of the large corporations they audit. Arthur Andersen & Company has published average earnings of its partners in its annual report, but there is no indication of the compensation received by the top executives.

In view of the public interest in assessing the performance of prominent and influential business and professional executives in our society, I ask that you provide this subcommittee with information on the total compensation, including retirement benefits, earned by each of the three most highly-paid executives in your firm. It is not necessary that the individuals be named.

I also ask that you provide this subcommittee with the number of partners in your firm who are women and the number of partners who are blacks, along with the percentage of each group to the total number of partners in your firm.

Very truly yours,

Lee Metcalf

ARTHUR ANDERSEN & CO.

G. E. STANTON
VICE CHAIRMAN-ADMINISTRATION

69 WEST WASHINGTON STREET
CHICAGO, ILLINOIS 60602

July 16, 1976

Honorable Lee Metcalf, Chairman
Subcommittee on Reports,
Accounting, and Management
Committee on Government Operations
United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

This letter is in response to your inquiry of June 7, 1976, in which you requested that we provide your subcommittee with information on the total compensation, including retirement benefits, earned by each of the three most highly paid executives in our firm. You also requested that we provide your subcommittee with the number of partners in our firm who are women and the number of partners who are blacks, along with the percentage of each group to the total number of partners in our firm.

Participation in our partnership income is not comparable to compensation paid to corporate executives for various reasons, including those listed below (and further explained in subsequent paragraphs):

1. The amount of participation in partnership income is dependent solely upon each year's operating results. There is no guaranteed or contractual annual salary as is usually true for corporate executives.

2. Substantial capital investment is required of each partner and this investment must be made from "after tax" income. Such capital is at risk without return in the form of interest, dividends, or possible appreciation in value.

3. Partners must provide for their own retirement benefits whereas provisions for retirement benefits to corporate executives are usually in addition to their annual compensation.

4. Partners must personally pay all self-employment (social security) taxes and group insurance premiums for medical, disability, accident and life insurance coverage. In addition, each partner is required to pay nonresident state income taxes on partnership earnings which would not normally be required of corporate executives.

Upon admission to our firm, each partner is required to invest substantial capital to finance our practice. No interest is paid on this investment. In contrast, corporate executives often make no capital investment in their company; or if they do, their investment usually yields a return in the form of dividends or interest income and frequently such capital investments appreciate in value over the years. Such corporate capital investments are often made under option arrangements to purchase stock at favorable prices. When our partners leave our firm, they are repaid only the amount invested. There are no compensatory features for any erosion of their capital investment by reason of inflation during their career with the firm, nor do the partners receive any payment for unrealized appreciation of any assets of the firm. Although the basic philosophy of our firm is to borrow on a long-term basis (from a nonclient insurance company) to fund our investment in property and equipment (principally leasehold improvements, furniture and equipment), our long-term borrowings for property and equipment have generally been less than our total investment in such assets; thus, partner capital has financed a portion of our investment in property and equipment in addition to the firm's substantial working capital needs. We believe it to be in the public interest for the partners to provide the major portion of the firm's capital in order to maintain independence and objectivity in our professional practice.

The United States Internal Revenue Code does not permit partner retirement programs to be funded in the same manner as corporate executive retirement programs. The Keogh legislation provided for modest self-funding of retirement plans by partners, and in 1969 we established a Keogh-type plan in which a number of our United States partners participated on a voluntary basis. Until 1974, the maximum annual contribution a partner could make was $2,500. The present maximum annual contribution under our plan is 5% of earnings (as defined) or $5,000, whichever is less, and participation by all of our United States partners is mandatory. Participation in this plan during a partner's career will provide retirement benefits which are considerably lower than those provided for many corporate executives of similar executive stature.

Each partner must personally pay self-employment (social security) taxes at a higher rate than an individual corporate executive pays since a partnership is not permitted to pay the company portion of social security taxes for partners. Similarly, each partner pays the entire premium for group medical, disability, accident and life insurance whereas corporate executives usually pay only a part or none of such group insurance premiums.

The partnership income of the three partners having the highest participation in our firm was as follows for the fiscal year ended August 31, 1975:

	A	B	C
PARTICIPATION IN PARTNERSHIP INCOME (including unrealized earnings)	$429,843	$388,716	$349,609
RETIREMENT BENEFITS (not funded):			
Basic annual retirement benefit payable commencing at age 62 for life or ten years certain (subject to annual increase or decrease based on an appropriate price index--may be rescinded at any time upon approval by two-thirds of the partners)	$ 12,000	$ 12,000	$ 12,000
Supplementary retirement benefits payable upon resignation, removal, retirement or death--payable in lump sum or in installments over a period of not more than six full fiscal years after the fiscal year in which the event occurs, together with interest at 5% on the unpaid balance (See Note)	$416,371	$508,208	$430,229
CAPITAL INVESTMENT AS OF AUGUST 31, 1975:			
Paid-in capital	$200,000	$180,000	$160,000
Pro forma capital (unrealized earnings reinvested in the business)	222,470	331,632	235,407
Total	$422,470	$511,632	$395,407

NOTE: Prior to September 1, 1974, retired partners participated in income following retirement for 16 consecutive months or, alternatively, at a rate of one-fourth of normal income participation for 76 consecutive months. Effective July 1, 1974, that retirement benefit program was rescinded by the partners and 16 month benefits earned as of that date were computed and frozen in amount. The frozen retirement benefits were discounted at the rate of 5% for each year by which a partner's age was less than 55, and such discount is being restored proratably if the partner continues active with the firm. In lieu of that retirement program, effective July 1, 1974, an annual contribution of 5% of defined earnings (up to a maximum of $5,000) to the firm's Partners' Profit Sharing Trust (Keogh Plan) was made mandatory for each partner.

Included in the partnership income participation set forth above are each partner's share of (a) charitable contributions made by the firm ($11,627, $10,464 and $9,302, respectively), (b) foreign income taxes paid by the firm ($10,656, $9,590 and $8,525, respectively), and (c) a moving resettlement allowance ($7,000) with respect to partner C, all of which are required by the United States Internal Revenue Code to be included in the partner's taxable income. Also included are $6,339, $11,962 and $7,806, respectively, of unrealized earnings.

In addition to the above listed charitable contributions made by the firm and included in individual partner earnings, under the firm's contributions program each of these partners was also required to contribute personally not less than $8,800, $7,920 and $7,040, respectively, to educational, health and welfare, civic, cultural or other charitable organizations and institutions other than those of a religious or political nature. Contributions to the latter type organizations are entirely personal and in addition to the firm's contributions program. Under the firm's contributions program, aggregate contributions of not less than approximately 4% of annual cash earnings are required (2% to be made by the firm and 2% by the individual partners).

I believe that this background information will provide you and the members of your subcommittee the perspective needed to relate our response to your inquiry to the "Annual Survey of Executive Compensation" published in the May 10, 1976, issue of Business Week.

We recently announced that 100 new partners, participating principals, overseas representatives and non-United States principals (all referred to herein as "partners") will be admitted to the firm effective September 1, 1976. With these 100 newly admitted partners, we will have 1,022 partners in our firm as of September 1, 1976, of which 203 will be nationals of countries other than the United States. Among those being admitted to the partnership in 1976 are our first two black partners and our first woman partner.

In considering the number of women and blacks at the partnership level, it is necessary to comment on availability, the development period required to achieve partnership and the problem of personnel retention. Prior to the mid-sixties there were only a limited number of women and blacks graduating from universities with appropriate qualifications for employment in the public accounting profession. Since that time, there has been a substantial increase in the number of women majoring in accounting and available for employment. We currently employ approximately 600 women on the professional staff of our United States offices, of which 32 have progressed to the manager level. Although the number of blacks available for employment has increased somewhat, the supply is still limited in relation to the opportunities available. According to survey data compiled by the American Institute of Certified Public

Accountants as of October 1, 1974 (the latest information available to us), the 208 black professionals employed by our firm at that date (10 of whom had progressed to the manager level) constituted about 20% of the total number of black professionals employed by the 33 firms responding to the AICPA survey (which included the 20 largest accounting firms in the United States).

Currently, the development period to achieve partnership status in our firm ranges from ten to fifteen years. Historically, over a period of approximately 30 years, 36% of those admitted to partnership had been with the firm 10 years or less before admission (most of those admitted had been with the firm 10 years; many of those with the firm for less than 10 years when admitted had prior employment experience before joining the firm), 45% were with the firm 11-12 years and 19% were with the firm more than 12 years. In recent years, approximately 11% of the professional personnel employed by our firm in the United States have become partners.

The personnel retention rate for our firm (and for the public accounting profession) is significantly lower than for many industries because (1) the requirements of a professional service organization are very demanding, (2) in order to maintain the quality of service to discharge our public interest responsibilities, we do not have career professional employees since we have found that only about one in ten employees is qualified to handle partner responsibilities, and (3) the outside employment market for persons with public accounting experience is very attractive. The retention rate for women and blacks is even lower than our experience for other personnel.

Considering the relatively recent entry of women and blacks into the public accounting profession, the development period required to achieve partnership status and our personnel retention experience, we only now are reaching the point in time when there should be an increasing number of women and blacks available for partnership consideration.

Please contact Mr. Harvey Kapnick, Chairman and Chief Executive of our firm, or Mr. Charles A. Bowsher, a partner in our Washington, D.C. office who is the Director of our Federal Government Liaison Group, or me if we can be of further assistance in discussing these matters or providing additional information.

Very truly yours,

S D Stanton

ARTHUR YOUNG & COMPANY

277 PARK AVENUE
NEW YORK, N. Y. 10017

June 30, 1976

The Honorable Lee Metcalf
Chairman
Subcommittee on Reports,
Accounting, and Management
United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

This will acknowledge your letter of June 7 which was received during the period I was away from my office.

We find it difficult to understand why the compensation of our partners is a matter of valid interest to a subcommittee of the Committee on Government Operations. We are even more perplexed with the suggestion that this could be a matter of importance in an assessment of our professional performance.

Along with these reservations we also confess to a deep-rooted belief that members of a private partnership have a right to maintain privacy over such matters if they wish to do so. Therefore, absent an understanding of its justification, we respectfully decline to furnish the compensation information you have requested.

Two partners (.5% of the total number of our partners) are female. None of our partners are blacks.

Yours very truly,

William Kanaga

William S. Kanaga

COOPERS & LYBRAND
1251 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10020

PHILIP L. DEFLIESE
MANAGING PARTNER

July 20, 1976

The Hon. Lee Metcalf, Chairman
Subcommittee on Reports, Accounting,
and Management
Committee on Government Operations
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

Your letter of June 7, 1976 requests that Coopers & Lybrand provide your Subcommittee with information on (1) the total compensation, including retirement benefits, earned by each of the three most highly paid executives in our Firm, and (2) minority statistics.

Compensation

As you know, although we remain unclear about the status or purpose of the various requests we have received from your Subcommittee, we have sought to be cooperative in gathering and furnishing the requested information. Nevertheless, our exchange of letters (yours of March 1 and mine of March 26) confirmed our understanding that lack of confidentiality is necessary to the work of your Subcommittee. In this regard I note that we have not received any response to our request made in the last paragraph of my letter to you of March 26, 1976. In the interest of confidentiality, we believe that supplying any normally private financial information would be detrimental to the substantial interests of our partners and of no apparent relevance to the work of your Subcommittee. Our reasons for declining this request are more fully explained below.

Confidentiality, Privacy and the Law

It is understandable that a natural curiosity exists about the compensation of executives and professionals, particularly senior attorneys in prominent

law firms, prominent doctors, and leading accountants. Yet, although the public is served by these professionals, the relevant sections of the Internal Revenue Code demand that their incomes remain private. Certainly, clients and patients do not engage their professionals on this basis. Although law firms exert great influence, particularly with respect to the formulation of the nation's laws, we have never believed that curiosity gave rise to a right to know their compensation. Likewise, it is our belief that the compensation of the partners of this Firm is a private matter recognized in law.

Your letter refers to the present disclosure requirements regarding top corporate executive compensation. Congress, through the securities laws, has required that companies which offer their securities to the public disclose a wide variety of financial information including the compensation of their senior executives. This is understandable because public shareholders have a right to know how their resources (corporate funds) are managed and to evaluate management's allocation thereof. Congress did not seek, and has not to my knowledge sought, to have private organizations, whether they be in corporate or partnership form, disclose their economic circumstances.

The Internal Revenue Code guarantees confidentiality to the tax returns filed by private partnerships. It is my understanding from the daily newspapers that the current Congress is seeking ways in which to enhance and enforce the confidentiality expected by private business organizations and individuals with respect to their compensation as reported in their income tax returns. I presume that your Subcommittee is in sympathy with this effort.

<u>Comparability</u>

Compensation to a professional in a partnership is of a vastly different nature and character than compensation to an executive in a public corporation. In a partnership, the compensation of the most senior and the most junior partners is directly and

immediately affected by the profits and losses of the partnership for the particular year. Since most professional firms are on a cash basis, such compensation is also affected by the incidence of collection of fees. (Thus partners' compensation may fluctuate year to year with both the economy and collections.) Also, a portion of the profits should be ascribed to a return on capital which partners are required to contribute in substantial amounts. This is not so in a corporation in which compensation of executives, exclusive of bonuses, is rarely affected by short-term profit swings of the business organization, nor is it affected by the size of the executive's investment (if any) in stock of the corporation. Moreover, under Federal law all profits of a partnership must be allocated to the partners, in direct contrast to the situation with respect to a public corporation. Thus, comparisons become even more misleading.

It is obvious that some individuals seek to practice in a private professional atmosphere, rather than joining a public corporation. In doing this, these individuals give up many benefits enjoyed by those employed by public corporations. These include more generous pensions made possible by the favorable tax laws enjoyed by corporations, stock options and various other stock purchase benefits, bonus plans, etc. To make comparison between the private professional and the executive in a public corporation is unfair and misleading. Compilation of the statistics sought by your Subcommittee would be even more misleading without consideration of the personal liability of professionals practicing in a partnership. There is nothing comparative for a corporate executive. Each partner of my Firm and of all other accounting firms, large and small, has pledged his full personal financial position to the satisfactory performance of his professional obligations. Literally, no corporate executive can make that statement.

Relevancy

I can discern no reason why the level of compensation set within this Firm for any partner has any bearing on the legislative or oversight functions

of the Committee on Government Operations, or any subcommittee of that Committee. Since we have always treated this information as confidential and believe we are entitled to do so, we prefer to continue to do so.

We recognize that certain accounting firms (you refer to Arthur Andersen & Company), have deemed it appropriate to publish financial information with respect to themselves. While we do not dispute a professional firm's legal right to disclose its financial structure, we do not believe it is any indication of the quality of service rendered. We believe such information can be useful (to the detriment of smaller firms that may be unable to compete) in recruiting graduates and other professionals (although we prefer to use a different approach), but we doubt whether clients or the public would be influenced.

For instance, if the gross billings of the largest of the Big 8 firms are (in the U.S.) twice the smallest, does this in any way indicate that the firm twice as large is any more competent to render professional services? Once an accounting firm has passed a certain size which enables it to hire good people and adequately train them, and which enables it to sustain the substantial costs involved in world-wide geographic coverage and quality control, I do not think an increase in gross billings indicates any increase in the quality of its professional practice. Periodic disclosure of financial results could stimulate a growth syndrome so prevalent in industry which, in turn, might influence a firm's selectivity and independence in dealing with clients.

With respect to the profitability of a firm, completely diametrically opposite conclusions can be reached. If Firm A is more profitable to its partners than Firm B, does this mean that Firm A "cuts corners?" Does it mean that Firm B spends more money on recruiting better paid personnel, and on training and quality control, thereby reducing the profit to its partners? I do not think it is fair to draw either of these conclusions.

Accounting firms seek and wish to have the public's confidence in their professional integrity and competence. To even imply to the public that this can be judged by the size or the profitability of an accounting firm (or its highest executives) is a disservice both to the public and to the accounting profession.

Minorities

Your other request with respect to the numbers of women and black partners raises grave questions since it is hard for us to recognize any plausible nexus between the requested information and the jurisdiction of your Subcommittee, or to understand the omission of reference to other minorities. Nevertheless, we are willing to report that we are an equal opportunity employer with a strong affirmative action program and a record of subsidizing minority scholarships and related educational assistance in the accounting field. Accordingly, our organization includes minorities at all levels. We report on these matters to other governmental agencies, providing comprehensive statistics. Because these matters are substantially in the public record, we can report (for the U.S. Firm) that among our staff and our partners and principals, including those expected to be admitted October 1, 1976, are approximately the following:

	Partners and Principals	Professional Staff (4/76)
Total for the Firm	611	4,606
Women (including minorities)	2	540
Blacks	1	122
Orientals	7	67
Spanish Surname	8	49
American Indian	0	3

(Approximations are given on the basis of best estimates since, I believe, law forbids formal recording.)

Since discrimination for creed no longer seems to be, no relevant statistics are given. However we have large numbers of Jewish and Roman Catholic people at all levels. It should also be recognized that membership in the management group reflects the impact of educational realities of the past few decades.

I wish to reiterate that this Firm stands ready to continue its cooperation with your Subcommittee in what we were originally informed was its ongoing effort to develop a general understanding of the accounting profession and its relationship to the Federal government.

Your several requests on behalf of your Subcommittee, which seem to lead in various directions, and our general lack of knowledge of their objectives and direction or purposes of its inquiry lead me to wonder whether it would not be helpful for us to meet personally to discuss the matter on an informal basis. I would welcome such an opportunity and stand ready to meet with you at your convenience.

Very truly yours,

Philip L Defliese

PLD:dem

ERNST & ERNST

UNION COMMERCE BUILDING

CLEVELAND, OHIO 44115

June 24, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on Reports,
Accounting and Management
Committee on Government Operations
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

This will acknowledge receipt of your letter dated June 7, 1976.

As to your question regarding the participations of our three most highly paid executives, before we respond, I feel obligated to consult with our Managing Committee. In anticipation of an early meeting of that Committee, it would be helpful to me in explaining the reasons for your request, if I had from you a more complete statement of the purpose of your Subcommittee in requesting this information.

Your letterhead indicates that your Subcommittee is proceeding under the authority of Section 7 of S. Res. 363. As we read that section, the investigations there authorized relate exclusively to operations of the Federal government. The only provision in S. Res. 363 that we see which points toward inquiries to be made of the private sector appears in Section 5, in connection with investigations involving improper expenditures of government funds. It is not readily apparent how the compensation of selected executives of our firm would be germane to such an investigation, or to Section 7 investigations. This is particularly true in view of the fact, as disclosed by our response of February 12, our services performed for Federal departments, agencies, subdivisions or authorities has constituted such a tiny proportion of our total activities. But in any event, I shall greatly appreciate your further elaboration of the purpose of your request and its relevance to the investigations authorized by Section 7 of S. Res. 363.

Answering your second question regarding the number and percentage of our partners who are women and who are black, we have one black partner and no women partners out of the number of 484 partners reported in our letter of February 12, 1976, in answer to yours of December 19, 1975. We have on our professional (as distguished from clerical) staff 450 women and 120 blacks in various stages of advancement. You will recognize that, in past years, the accounting profession was not one which was sought out by women or minorities, and that it is therefore taking time to develop and train personnel in these groups who are qualified for partnership in our firm.

Sincerely,

R. T. Baker

R. T. Baker
Managing Partner

RTB/nm

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

28 June, 1976

Mr. R. T. Baker
Managing Partner
Ernst & Ernst
Union Commerce Building
Cleveland, Ohio 44115

Dear Mr. Baker:

In your letter of 24 June, you question the authority of this subcommittee to request information from your firm on various subjects. You note that our authority is primarily directed to the accounting practices of Federal departments and agencies.

Our requests for information from your firm are based on the unusual and substantial relationship which has developed between certain Federal agencies and influential segments of the accounting profession. This relationship has led to official recognition by Federal agencies of judgments on binding accounting standards which have been made entirely within the private sector. The Securities and Exchange Commission has even formalized its acceptance of private decision-making through Accounting Series Release 150. The Moss amendment to the Energy Policy and Conservation Act (H. R. 7014) also contemplates Federal recognition of private decisions on the manner of uniform accounting to be developed for the oil and gas industry.

The substantial reliance by Federal agencies upon decisions made in the private sector represents a significant delegation of the statutory authority vested in those agencies. This arrangement involves important decisions affecting the policies of the Federal government and other segments of our society.

Decisions made by Federal agencies are subject to review by Congress and the public. Much progress has been made both in Congress and the Federal government in opening the processes of decision-making to public scrutiny. The public has a right to know the identity and interests of those who act under the public's authority to determine the directions which this nation shall take.

When public decision-making authority is delegated to the private sector, the public has an even greater interest in knowing who is directing important national policies. As you are well aware, little information is available to Congress or the public concerning the activities of accounting firms. That is why it is necessary for this subcommittee to request information on various activities of accounting firms.

Your firm is substantially involved in the private decision-making process which develops accounting standards that are recognized by Federal agencies. The information which has so far been requested by this subcommittee is only a small fraction of the information that is publicly available regarding the identity and interests of Federal officials, or even major corporate officials. Yet, the decision-making area in which your firm is involved influences public policy as much or more than do many companies for which the requested information is publicly available.

This subcommittee has a responsibility to ensure that Federal accounting practices are responsive to the public interest. We must be informed on matters which are relevant to Federal accounting practices. That is why your firm has been requested to provide information to this subcommittee.

Very truly yours,

Original signed by
Lee Metcalf

ERNST & ERNST
UNION COMMERCE BUILDING
CLEVELAND, OHIO 44115

September 1, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on Reports,
Accounting and Management
Committee on Government Operations
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

As I indicated that I would in my letter of June 24, I have consulted with the Managing Committee of our firm, in the light of your response of June 28 to my inquiry. I should note in response to your letter that the only point on which we have questioned the appropriateness of your Subcommittee's request for information relates to the demand for the income from our firm of the three most highly compensated partners - information which, in the absence, as here, of a public ownership of the enterprise, is universally regarded as confidential.

Nothing in your letter of June 28 has persuaded our Managing Committee of a public interest in the disclosure of this information. You refer to the "unusual and substantial relationship which has developed between certain Federal agencies and influential segments of the accounting profession * * * (which) has led to official recognition by Federal agencies of judgments of pending accounting standards which have been made entirely within the private sector. The Securities and Exchange Commission has even formalized its acceptance of private decision-making through Accounting Series Release 150." However, neither this firm nor, so far as we are aware, any other individual accounting firm, exercises any such authority. The Financial Accounting Standards Board is the organization which is looked to for synthesizing generally accepted accounting standards. This Board, as your staff knows from having scrutinized in great detail its constitution and procedures, is entirely independent of this or any other firm. We cannot believe that the partners of our firm are among "those who act under the public authority to determine the directions which this Nation is taking."

Having fully responded to all inquiries save this one, we should be glad to consider any further suggestions that you may make regarding the relevance of this confidential information to the appropriate inquiries of your Subcommittee.

Sincerely,

R. T. Baker

R. T. Baker
Managing Partner

RTB/nm

HASKINS & SELLS

CERTIFIED PUBLIC ACCOUNTANTS

MICHAEL N. CHETKOVICH
MANAGING PARTNER

EXECUTIVE OFFICE
1114 AVENUE OF THE AMERICAS
NEW YORK, NEW YORK 10036

July 15, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on Reports,
Accounting and Management
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

This is in response to your letter of June 7, 1976 requesting certain information concerning our Firm. I would like to take this opportunity at the outset to thank you for the courtesies extended by Messrs. Reinemer and Turner of the staff of the Subcommittee to Charles G. Steele and Allan Kramer of our Firm in their meeting on July 9. They found the meeting to be very helpful in adding to our understanding of the objectives of the Subcommittee.

In response to your request for the number of partners who are women and the number of partners who are blacks, along with the percentage of each group to the total number of partners, we are providing the following information:

Partners in the United States Firm	Number	Percent
Total partners	492	100
Women partners	1	.2
Black partners	0	--

In addition to the above, partners of our affiliated international firms include one additional woman partner and five black partners.

As Mr. Steele explained to Mr. Reinemer and Mr. Turner, to consider the extent of our emphasis on the hiring and advancement of members of minority groups, we believe that several important factors should be mentioned:

- Partners of Haskins & Sells are responsible for all services performed in the name of the Firm. Because of the importance of these

responsibilities, an individual cannot be admitted as a partner until he or she has demonstrated certain abilities and judgment developed over a period of years as an employee of the Firm. The partners admitted in the United States this year averaged 12 years of experience with Haskins & Sells.

- We actively recruit and train members of minority groups. In March 1976, 587 women, 88 blacks, 70 Orientals and 55 Spanish Americans were employed in our U.S. offices as managers, supervisors, staff accountants or in other professional capacities.

- Most individuals who have several years of public accounting experience receive one or more job offers from other business organizations. We have found that minority group members who have earned their CPA certificates are particularly attractive to the business and professional community. In spite of our efforts to retain and promote these individuals, many are attracted by different responsibilities or by higher salaries, and so choose to leave public accounting.

For further information concerning our programs and activities in support of minorities, you may refer to the enclosed "Summary Report of Programs and Activities Relating to Minority Group Members" dated June 1, 1976.

We hope that you recognize the challenges we face and the commitments we have made to emphasize equal opportunity. We believe that many of the minority group members we have hired and whom we now are training and helping to develop will choose to remain with Haskins & Sells, and that they will demonstrate the abilities and judgment we require for admission as partners.

We have given further careful thought to your request for the total compensation of the three most highly paid executives (partners) in our firm and have concluded that we would prefer not to give such information at this time. While we wish to cooperate with the Committee in every way we can, we do not believe that this information could be of significant value to the Committee to warrant its submission in view of the traditional confidentiality of such data and the possible adverse effects of its disclosure.

As Mr. Steele explained to Mr. Reinemer and Mr. Turner, the principal reason for our reluctance is that compensation of partners always has been a private matter in an entity such as ours, which has no public ownership, and so has been disseminated only among the partners themselves. We believe that our private status represents a significant distinction from that of senior executives of corporations owned widely by the public at large, whose compensation is required to be disclosed to shareowners by statute or regulation.

While our Firm, like all accounting firms is subject to the jurisdiction of Boards of Accountancy or similar regulatory bodies in every state in which we practice and also to the jurisdiction of the Securities and Exchange Commission to the extent provided by law, we are not required to and do not furnish information about partners' compensation to any such agency.

We believe that any benefits that might be derived from the disclosure of such information in these circumstances, even without identifying the partners in question, would be far outweighed by the disadvantages which we see, not only to us, but to the practice of the profession in general.

If it is considered that some public disclosure with respect to compensation of partners of accounting firms is necessary or useful to the public interest, then we would respectfully suggest that such need or utility be studied and identified so that proper thought can be given to the nature and extent of the information to be disclosed and to the delineation of the entities which would be required to make such disclosure.

Yours very truly,

Michael N. Chetkovich

Michael N. Chetkovich

Enclosure

(Enclosure retained in committee files.)

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
345 PARK AVENUE
NEW YORK, NEW YORK 10022

VICTOR M. EARLE III
GENERAL COUNSEL

June 25, 1976

Senator Lee Metcalf
United States Senate
Committee on Government Operations
Washington, D.C. 20510

Dear Senator Metcalf:

Walter Hanson, who is presently away from the office on a two-week holiday, has asked me to reply to your letter of June 7.

Peat, Marwick, Mitchell & Co. is not a publicly-held corporation, as you recognize. Although the Firm is large, it is nonetheless a partnership of professionals. The partners annually share the profits of the Firm (which can vary widely with the economy and the need for services) in a fashion that is satisfactory to them. For example, no one partner's share is as much as 1% of the profits. The sharing takes into account the particular partner's level of responsibility within the Firm, past and present professional achievements, length of service, and the extent of his or her capital investment. For these and a host of other reasons, it is a mistake to consider the Firm in the light of the fundamentally different policies underlying the proxy requirements governing corporate executives. Those policies insure that the multitudes of public shareholders are suitably informed when they vote on management and director slates.

Second, it would be unfair to the partners of the Firm -- indeed, a breach of faith -- to comply with your request. Many young people join professional organizations, passing up more lucrative and secure corporate careers, precisely because of the privacy that such a choice affords. They forego the stock and stock options, the fringe benefits, and the corporate politics, in favor of the comraderie, mutual trust, and confidentiality of a professional partnership. Nor are these attitudes confined to accounting firms. I can well imagine the reaction were your request directed to my former law firm, Cravath, Swaine & Moore, or to some of the major Washington firms such as Covington & Burling and Arnold & Porter.

The invasion of privacy I fear is not overcome by your suggestion that the three individuals remain anonymous. At least two of the three are readily identifiable. Both Walter Hanson, as Senior Partner, and Joseph Cummings, as Deputy Senior Partner (formerly a member of the Accounting Principles Board, now Chairman of the International Accounting Standards Committee) have attained national reputations in the professional and business communities.

You have also inquired about women and blacks in the Firm. Each of the offices has an Affirmative Action Program meeting the requirements of the EEO regulations. The Firm is rather proud of the progress made over the past few years. For example, you will notice from the enclosed statistics that women and minority group persons are represented at all staff levels within the Firm.

Sincerely,

VME:tga
Enclosure

Standard Form 100
(Rev. 12-75)
Approved GAO B-180541 (R0077)

EQUAL EMPLOYMENT OPPORTUNITY

EMPLOYER INFORMATION REPORT EEO-1

Joint Reporting Committee

- Equal Employment Opportunity Commission
- Office of Federal Contract Compliance

USE THIS FORM FOR YOUR CONSOLIDATED REPORT

SIC= 893

293103 FI=135565207 8

NY 10022 1

Section A — TYPE OF REPORT

Refer to instructions for number and types of reports to be filed.

1. Indicate by marking in the appropriate box the type of reporting unit for which this copy of the form is submitted (MARK ONLY ONE BOX)

(1) [ ] Single-establishment Employer Report

Multi-establishment Employer
(2) [X] Consolidated Report
(3) [ ] Headquarters Unit Report
(4) [ ] Individual Establishment Report (submit one for each establishment with 25 or more employees)
(5) [ ] Special Report

2. Total number of reports being filed by this Company (Answer on Consolidated Report only) 86 plus this Report

Section B — COMPANY IDENTIFICATION *(To be answered by all employers)*

OFFICE USE ONLY

1. Name of Company which owns or controls the establishment for which this report is filed (If same as label, skip to item 2 this section) a

Address (Number and street) | City or town | County | State | ZIP code b

b. Employer Identification No. 1 3 5 5 6 5 2 0 7

2. Establishment for which this report is filed

a. Name of establishment c.

Address (Number and street) | City or town | County | State | ZIP code d.

b. Employer Identification No. (If same as label, skip.)

3. Parent or affiliated company (Multi-establishment Employers: Answer on Consolidated Report only)

a. Name of parent or affiliated company | b. Employer Identification No.

Address (Number and street) | City or town | County | State | ZIP code

Section C — EMPLOYERS WHO ARE REQUIRED TO FILE *(To be answered by all employers)*

[X] Yes [ ] No 1. Does the entire company have at least 100 employees in the payroll period for which you are reporting?

[X] Yes [ ] No 2. Is your company affiliated through common ownership and/or centralized management with other entities in an enterprise with a total employment of 100 or more?

[X] Yes [ ] No 3. Does the company or any of its establishments (a) have 50 or more employees AND (b) is not exempt as provided by 41 CFR 60-1.5, AND either (1) is a prime government contractor or first-tier subcontractor, and has a contract, subcontract, or purchase order amounting to $50,000 or more, or (2) serves as a depository of Government funds in any amount or is a financial institution which is an issuing and paying agent for U.S. Savings Bonds and Savings Notes?

NOTE: If the answer is yes to ANY of these questions, complete the entire form, otherwise skip to Section G.

Section D — EMPLOYMENT DATA

097-470

Employment at this establishment—Report all permanent, temporary, or part-time employees including apprentices and on-the-job trainees unless specifically excluded as set forth in the instructions. Enter the appropriate figures on all lines and in all columns. Blank spaces will be considered as zeros.

In columns 1, 2, and 3, include ALL employees in the establishment including those in minority groups.

Job Categories (See Appendix (5) for definitions)	TOTAL EMPLOYEES IN ESTABLISHMENT			MINORITY GROUP EMPLOYEES (See Appendix (4) for definitions)							
				MALE				FEMALE			
	Total Employees Including Minorities (1)	Total Male Including Minorities (2)	Total Female Including Minorities (3)	Negro (4)	Oriental (5)	American Indian * (6)	Spanish Surnamed American (7)	Negro (8)	Oriental (9)	American Indian (10)	Spanish Surnamed American (11)
Officials and managers	1,898	1,695	203	12	11		16	2	2	1	4
Professionals	4,727	4,029	698	131	58	6	59	38	20		10
Technicians	18	16	2	1			2		1		
Sales workers											
Office and clerical	1,779	273	1,506	50	8	1	17	124	30	5	60
Craftsmen (Skilled)											
Operatives (Semi-skilled)											
Laborers (Unskilled)											
Service workers											
TOTAL →	8,422	6,013	2,409	194	77	7	94	164	53	6	74
Total employment reported in previous EEO-1 report	8,471	6,195	2,276	211	73	4	97	161	54	5	71

(The trainees below should also be included in the figures for the appropriate occupational categories above)

Formal On-the-job trainees		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
	White collar											
	Production											

* In Alaska include Eskimos and Aleuts with American Indians

1 NOTE On consolidated report, skip questions 2-5 and Section E

2 How was information as to race or ethnic group in Section D obtained?

1 [X] Visual Survey 3 [ ] Other — Specify ....

2 [ ] Employment Record

3 Dates of payroll period used — February 20, 1976

4 Pay period of last report submitted to this establishment February 28, 1975

5 Does this establishment employ apprentices?

This year? 1 [ ] Yes 2 [X] No

Last year? 1 [ ] Yes 2 [X] No

Section E — ESTABLISHMENT INFORMATION

1 Is the location of the establishment the same as that reported last year?

1 [X] Yes 2 [ ] No [ ] 3 [ ] Did not report last year 4 [ ] Reported on combined basis

2 Is the major business activity at this establishment the same as that reported last year?

1 [X] Yes 2 [ ] No 3 [ ] No report last year 4 [ ] Reported on combined basis

OFFICE USE ONLY

3 What is the major activity of this establishment? (Be specific, i.e., manufacturing steel castings, retail grocer, wholesale plumbing supplies, title insurance, etc. Include the specific type of product or type of service provided, as well as the principal business or industrial activity.)

Public Accounting

Section F — REMARKS

Use this item to give any identification data appearing on last report which differs from that given above, explain major changes in composition or reporting units, and other pertinent information.

Section G — CERTIFICATION (See instructions G)

Check one

1 [X] All reports are accurate and were prepared in accordance with the instructions (check on consolidated only)

2 [ ] This report is accurate and was prepared in accordance with the instructions

Name of Certifying Official	Title	Signature	Date
James A. Morgan	Partner		June 30, 1976

Name of person to contact regarding this report (Type or print)	Address (Number and street)				
Donald C. Bird	345 Park Avenue				
Title	City and State	ZIP code	Telephone Area Code	Number	Extension
Director of ~~Recruiter~~ AAP	New York, N.Y.	10022	(212)	758-9700	8111

All reports and information obtained from individual reports will be kept confidential as required by Section 709 (e) of Title VII

WILLFULLY FALSE STATEMENTS ON THIS REPORT ARE PUNISHABLE BY LAW, U.S. CODE, TITLE 18, SECTION 1001

Price Waterhouse & Co

1251 AVENUE OF THE AMERICAS
NEW YORK NEW YORK 10020
212 489 8900

June 10, 1976

The Honorable Lee Metcalf
United States Senate
Committee on Government Operations
Subcommittee on Reports, Accounting
and Management
Washington, D. C. 20510

My dear Senator Metcalf:

In response to your letter of June 7, 1976, please be informed that the income of the three most highly compensated active partners of this firm for the year ended June 30, 1975 (our most recent fiscal year) was $316,134, $297,920 and $281,275. As to retirement arrangements, the participation of each of the foregoing three partners during retirement will be 20%, 21% and 22%, respectively, of their share participation during fiscal 1975. The actual amount of that retirement benefit, which is in the form of a continuing participation in the profits of the firm, will depend on the income of the firm during each of their years of retirement and, thus, cannot now be estimated.

Of the present partners of the firm, one is a woman. We have no black partners at this time.

Very truly yours,

John C. Biegler

John C. Biegler

TOUCHE ROSS & CO.
1633 BROADWAY
NEW YORK, NEW YORK 10019

RUSSELL E. PALMER
Managing Partner
and
Chief Executive Officer

June 11, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on Reports,
Accounting and Management
Committee on Government Operations
U.S. Senate
Washington, D.C. 20510

Dear Senator Metcalf:

I acknowledge receipt of your letter of June 7, 1976. As you know, this firm has responded and in considerable detail to the Committee's earlier requests. However, we consider the information sought in this letter to exceed the scope of the Committee's investigative authority. Moreover, the information sought includes data proprietary to this firm and its individual members. As a result, we respectfully decline to provide the requested data.

Very truly yours,

Russell E. Palmer

REP/jr

APPENDIX E—THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

ABRAHAM RIBICOFF, CONN., CHAIRMAN
JOHN L. MC CLELLAN, ARK. CHARLES H. PERCY, ILL.
HENRY M. JACKSON, WASH. JACOB K. JAVITS, N.Y.
EDMUND S. MUSKIE, MAINE WILLIAM V. ROTH, JR., DEL.
LEE METCALF, MONT. BILL BROCK, TENN.
JAMES B. ALLEN, ALA. LOWELL P. WEICKER, JR., CONN.
LAWTON CHILES, FLA.
SAM NUNN, GA.
JOHN GLENN, OHIO

RICHARD A. WEGMAN
CHIEF COUNSEL AND STAFF DIRECTOR

SUBCOMMITTEE:
LEE METCALF, MONT., CHAIRMAN
JOHN L. MC CLELLAN, ARK. BILL BROCK, TENN.
EDMUND S. MUSKIE, MAINE CHARLES H. PERCY, ILL.
SAM NUNN, GA. LOWELL P. WEICKER, JR., CONN.
JOHN GLENN, OHIO

VIC REINEMER, STAFF DIRECTOR
E. WINSLOW TURNER, CHIEF COUNSEL
161 RUSSELL BUILDING

(202) 224-1474

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

7 May, 1976

Mr. Wallace E. Olson
President
American Institute of Certified
Public Accountants
1211 Avenue of the Americas
New York, New York 10036

Dear Mr. Olson:

As part of its responsibilitites concerning accounting practices of Federal agencies, this subcommittee is analyzing the relationship between Federal agencies and the accounting profession. For example, the Securities and Exchange Commission has stated through Accounting Series Release 150 that it intends to place great reliance upon findings of the Financial Accounting Standards Board.

The American Institute of Certified Public Accountants has been instrumental in the founding and operations of the FASB, as well as many other areas relating to accounting. Your staff has been very cooperative in providing the subcommittee with information regarding the activities of your organization, however, certain questions still remain.

In order that we may better understand the role of the AICPA in the framework of the accounting profession, please provide the subcommittee with the following information:

1. the amounts contributed directly or indirectly each year by the AICPA in support of the FASB, along with an explanation of

the Accounting Research Association and the relationship of its contributions to those listed in the AICPA statement of expenses;

2. a listing of all disciplinary actions taken by the AICPA since 1 January, 1970, including the date of action, the identities of the individuals and firms involved, the nature of the offense, the punishment rendered, and any subsequent actions by the AICPA relating to the disciplined individuals and firms;

3. an explanation of the role of the AICPA in developing and administering the Uniform Certified Public Accountant examination, along with a description of the examination and its application;

4. a listing of the periodicals published by the AICPA, including a description of the purpose, cost, and circulation of each;

5. a list of the members on each of the five advisory committees mentioned on page 43 of the 1975-65 AICPA Committee Handbook, along with a list of meetings held and recommendations made by each group since 1 January, 1974;

6. a description of the Commission on Auditors' Responsibilities, including the backgrounds and manner of selection of its members, and the amounts contributed directly or indirectly for its support; and

7. a list of those trustees of the Financial Accounting Foundation, FASB members, and FASB Advisory Committee members who are also members of the AICPA.

As we are trying to expedite our present accounting inquiry, I ask your cooperation in providing this information by 20 May. Any questions regarding this request may be directed to subcommittee counsel Jack Chesson at 202/224-1474.

Very truly yours,

ORIGINAL SIGNED BY
LEE METCALF

AICPA

American Institute of Certified Public Accountants
1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

June 7, 1976

The Honorable Lee Metcalf
United States Senate
Committee on Government Operations
Subcommittee on Reports, Accounting,
and Management
Washington, D.C. 20510

Dear Senator Metcalf:

I am writing in reply to your letter to me of May 7, 1976 in which you posed a number of questions through which you sought to develop a better understanding of the role of the Institute in the framework of the accounting profession.

As Ted Barreaux, AICPA vice president in Washington informed your staff, we were unable to compile the data you requested by May 28. We regret any inconvenience this unavoidable delay may have caused.

For the sake of simplicity, we have attached to this letter nine exhibits, each of which deals separately with the seven questions contained in your letter and the two additional questions given to us separately by Jack Chesson on the telephone.

We hope this input is helpful to you.

Sincerely yours,

Wallace E. Olson

Wallace E. Olson
President

WEO:Sc

Attachments

Exhibit 1

Question No. 1:

"the amounts contributed directly or indirectly each year by the AICPA in support of the FASB, along with an explanation of the Accounting Research Association and the relationship of its contributions to those listed in the AICPA statement of expenses;"

Response:

The American Institute of Certified Public Accountants contributes each year to the Financial Accounting Foundation, for the work of the Financial Accounting Standards Board, an amount equal to $2.00 for each member of the Institute. For the fiscal year ended July 31, 1975, this totaled $207,726 and was included in the Institute's operating statements under the "General" heading. This contribution is included as part of the overall commitment made by the Accounting Research Association to use its best efforts to raise sufficient funds from sources within the accounting profession to insure that the Financial Accounting Foundation receives at least $2,000,000 in each of the five years commencing January 1, 1973. Contributions made by the Accounting Research Association to the Financial Accounting Foundation on behalf of the accounting profession are not shown in the Institute's statement of expenses, but are included in the statement of expenses of the Accounting Research Association.

The Accounting Research Association was incorporated in 1967 as a business league. Among the purposes for which the corporation was organized are the following as stated in the Articles of Incorporation:

(a) To promote the progress and development of the accounting, auditing and other aspects of professional accountancy.

(b) To provide funds for studies and research in regard to principles and standards of the accounting profession in conjunction with the American Institute of Certified Public Accountants and others.

To accomplish these purposes, certified public accounting firms and individual members of the American Institute of Certified Public Accountants were invited to become dues paying members of the Association. Recognizing the need to finance accounting research and principle-setting efforts through procedures that would recognize ability to pay, the membership dues schedule of the Association provides for a range of dues depending on the size of the organization.

Page 2, Exhibit 1

The rates go from $25 for an individual member to a maximum of $200,000 per year for the larger accounting firms. In 1975, 2,090 accounting firms having members in the Institute and 2,525 individual practitioners and other individuals were dues paying members of the ARA.

In its earlier years, the Accounting Research Association provided support to the American Institute of Certified Public Accountants for accounting research and for the operational requirements of the Accounting Principles Board -- the rule making body of the profession which preceded the Financial Accounting Standards Board. With the establishment of the FASB, the Accounting Research Association stated its intent to use its best efforts to raise sufficient funds from sources within the accounting profession to insure that the Financial Accounting Foundation (the corporate entity which finances the FASB) receives in each of the five years commencing January 1, 1973, at least $2,000,000 from these sources. The membership dues received by the Accounting Research Association are used as required to meet this commitment.

Separate financial statements for the Accounting Research Association are included as part of the annual report of the American Institute of Certified Public Accountants.

Exhibit 2

Question No. 2:

"a listing of all disciplinary actions taken by the AICPA since 1 January, 1970, including the date of action, the identities of the individuals and firms involved, the nature of the offense, the punishment rendered, and any subsequent actions by the AICPA relating to the disciplined individuals and firms;"

Response:

In reviewing the response to this question, it should be kept in mind that members of the Institute are subject to a number of regulatory efforts -- those of the state boards of accountancy, the state CPA societies and the various federal and state regulatory agencies. The Institute's efforts at discipline therefore constitute only a part of the total picture.

Membership in the AICPA is on an individual basis; there are no "firm" memberships. Disciplinary action can be taken against individual members only; there neither are nor can be "disciplined.... firms."

From 1967 to date AICPA members have been liable to discipline under two distinct procedures. First, the so-called "automatic" provisions of the bylaws; second, discretionary action taken by the ethics division to charge individuals with specific violations of AICPA bylaws or the Code of Professional Ethics before a trial board hearing panel.

Since 1967, the AICPA bylaws have included a provision (variously phrased over time) which essentially mandates termination of membership upon final criminal conviction of:

- A felony (as defined by the convicting jurisdiction).
- Failure to file any personal income tax return required to be filed by law.
- Preparing or filing a fraudulent income tax return for a client.

For the same period the AICPA bylaws have also included a provision mandating coterminous suspension of AICPA membership with any period of suspension of a member's state CPA certificate and also termination of AICPA membership upon revocation of such CPA certificate.

The bylaws provide that in each case of automatic suspension or termination, a notice of the action will be published in the principal membership periodical and that the chairman of the trial board shall decide whether the member's name will be disclosed.

On the following pages are listed the instances in which these bylaws were applied. The names listed are those published in the principal membership periodical. Names have been omitted in those instances where the bylaws do not permit disclosure because there was a decision to not publish the names in the principal membership periodical.

Page 2, Exhibit 2

Automatic Procedures History

The following actions were taken from January 1, 1970 to date under the automatic procedures:

	Date of Action	Individual	Nature of Offense	Status of Membership After Application of Automatic Procedures
1.	7-71	Lehrer, Morton I.	Conviction of felony	Terminated
2.	7-71	Lesser, Morton	Conviction of felony	Terminated
3.	7-71	Vigman, Samuel	Conviction of felony	Terminated
4.	11-71	Glennie, Joseph	Revocation of CPA certificate	Terminated
5.	11-71	Kane, Robert J.	Conviction of felony	Terminated
6.	11-71	Harary, Charles	Conviction of felony	Suspended pending appeal (see subsequent action)
7.	7-71	Braver, Irving	Conviction of felony	Terminated
8.	12-71	Sternkopf, William	Conviction of felony	Terminated
9.	11-71	Willenborg, Thomas	Suspension of CPA certificate for term	Suspended for like term
10.	11-71		Suspension of CPA certificate for term	Suspended for like term
11.	11-72	Raffer, Milton	Conviction of felony	Terminated
12.	1-72	Cerny, Francis J.	Revocation of CPA certificate	Terminated

Page 3, Exhibit 2

	Date of Action	Individual	Nature of Offense	Status of Membership After Application of Automatic Procedures
13.	2-72	Feldman, Melvin	Conviction of felony	Terminated
14.	2-72	Cohn, Herbert J.	Conviction of felony	Terminated
15.	1-72	VanHook, Jr., George	Revocation of CPA certificate	Terminated
16.	1-72	Stern, Sidney	Revocation of CPA certificate	Terminated
17.	3-72	Perry, James	Failure to file own income tax returns	Terminated
18.	4-72	Day, Harry T.	Suspension of CPA certificate for term	Suspension for like term
19.	5-72	Levine, Lester	Revocation of CPA certificate	Terminated
20.	7-72	Pincus, Bernard	Revocation of CPA certificate	Terminated
21.	7-72	Ackerman, Morton S.	Conviction of felony	Terminated
22.	8-72	Bernstein, Herman	Conviction of felony	Terminated
23.	8-72	Cades, Ralph E.	Conviction of felony	Terminated
24.	11-72	Cohen, Benjamin	Conviction of felony	Terminated
25.	8-72		Conviction of felony	Terminated
26.	7-73		Suspension of CPA certificate for term	Suspension for like term
27.	7-73		Suspension of CPA certificate for term	Suspension for like term
28.	7-73		Suspension of CPA certificate for term	Suspension for like term

Page 4, Exhibit 2

	Date of Action	Individual	Nature of Offense	Status of Membership After Application of Automatic Procedures
29.	7-73		Suspension of CPA certificate for term	Suspension for like term
30.	4-75		Suspension of CPA certificate for term	Suspension for like term
31.	10-74	Portney, Jack M.	Conviction of felony	Terminated
32.	10-74		Suspension of CPA certificate for term	Suspended
33.	3-75	Sullivan, Robert	Failure to file own federal income tax return	Terminated
34.	10-74		Suspension of CPA certificate for term	Suspended for like term
35.	1-75	Dickerman, Hyman	Conviction of felony	Terminated
36.	1-75	Rennick, Julius	Conviction of felony	Terminated
37.	1-75	Newhouse, James	Conviction of felony	Terminated
38.	1-75	DeCesare, Michael	Failure to file own income tax returns	Terminated
39.	1-75	Takikawa, Tony	Conviction of filing false income tax return for client	Terminated
40.	1-75	Guerin, Joseph	Failure to file own income tax returns	Terminated
41.	1-75	Carrington, Franklyn	Failure to file own federal income tax returns	Terminated
42.	3-75	Silverton, Ronald	Revocation of CPA certificate	Terminated
43.	3-75	Hunt, James H.	Suspension of CPA certificate for a term	Suspension for a like term

Page 5, Exhibit 2

	Date of Action	Individual	Nature of Offense	Status of Membership After Application of Automatic Procedures
44.	1-75	Natelli, Anthony	Conviction of felony	Suspended pending appeal (see subsequent action)
45.	1-75	Scansaroli, Joseph	Conviction of felony	Suspended pending appeal (see subsequent action)
46.	3-75	Peacon, Oscar Lee	Conviction of felony	Terminated
47.	3-75	Swanson, Gordon R.	Failure to file own income tax returns	Terminated
48.	6-75	Mickey, Jerry D.	Suspension of CPA certificate for a term	Suspended for like term
49.	9-75	Warden, Donald W.	Conviction of aiding in the preparation of false and fraudulent income tax returns for clients	Suspended pending appeal
50.	8-75	Weiner, Julian	Conviction of felonies	Suspended pending appeal (see subsequent action)
51.	9-75	Capo, David J.	Conviction of felonies	Terminated
52.	9-75	Edens, Lloyd D.	Conviction of felonies	Terminated
53.	8-75	Lowell, Samuel B.	Conviction of felonies	Terminated

Page 6, Exhibit 2

	Date of Action	Individual	Nature of Offense	Status of Membership After Application of Automatic Procedures
54.	8-75	Lichtig, Marvin	Conviction of felonies	Suspended pending appeal
55.	3-76	Shure, Jerome J.	Failure to file own income tax returns	Terminated
56.	3-76	Babcock, Howard L.	Conviction of filing false income tax return	Terminated
57.	4-76	Stacey, George E.	Revocation of CPA certificate	Terminated
58.	5-76		Conviction of filing false income tax return	Terminated
59.	5-76		Conviction of felony	Terminated
60.	5-76		Failure to file own income tax returns	Terminated
61.	5-76		Failure to file own income tax returns	Terminated

Case No.	"Subsequent Actions" Re the Above
6.	Conviction was reversed on appeal. Reinstated under bylaws.
44.	Conviction affirmed - membership terminated.
45.	Conviction reversed - member may be retried - under "hold" at this time.
49.	Matter is still on appeal.
50.	Matter is still on appeal.
54.	Matter is still on appeal.

Page 7, Exhibit 2

In addition to the automatic procedures described above, the AICPA Professional Ethics Division has the authority to specifically charge members with violation of certain provisions of the AICPA bylaws and the Code of Professional Ethics in specific fact situations. Such charges were heard and determined by the AICPA trial board, none of whose members could be also members of an ethics committee or state board of accountancy, until July 31, 1975 when the Joint Ethics Enforcement Plan (between the AICPA and almost all state CPA societies over the United States) went into effect. A description of that plan, which unifies the disciplinary effort on both the state and national level is set forth in attachment 2-1.

On pages 8 to 18 following there is a tabulation of the hearings of formal charges referred to the trial board during the period requested. Such hearings can result in a finding of not guilty or guilty. If the finding is guilty, the member may be expelled, suspended for up to two years or admonished. The bylaws provide that in each case, the board must decide whether the report of the hearing which will be published in the principal AICPA membership periodical will identify the name of the member concerned. Since the only provision for such identification is as provided in the bylaws, the schedule reflects only those names which have been previously published.

Page 8, Exhibit 2

From January 1, 1970 to July 31, 1975 the following actions were taken:

	DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
1)	10/05/69	Nicholas R. Raftery	Failure to disclose material facts, disclosure of which was necessary to make the financial statements not misleading (Rule 2.02 (a), (c) and (e) and act discreditable.	Guilty as charged. Suspended for two years. Name mentioned in The CPA. Effective 10/5/69.
2)	10/06/69		1) Material negligence in conduct of examination and report thereon. (Rule 2.02 (c). 2) Expressed opinion when not independent. (Rule 1.01).	Guilty as charged. Suspended for twelve months. Not guilty. Name not mentioned in The CPA.
3)	3/25/70	Stanley Broskie	Convicted of conspiracy to bribe. (Art.V, Sec. 5) CPA certificate revoked (Art. V, Section 4(f).	Guilty as charged. Expelled. Name mentioned in The CPA.
4)	5/05/70	Robert B. Bruce	Revocation of Florida CPA certificate.	Guilty. Expelled. Name mentioned in The CPA.

Page 9, Exhibit 2

	DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
5)	1/14/71		Violation of Rule 3.02 (Solicitation)	Guilty as charged. Suspended for six months. Name not mentioned in The CPA on assurance violation would not be repeated. Effective 2/13/71.
6)	3/16/71		Violation of Rule 1.01 of Code of Professional Ethics (expressed unqualified opinion on financial statements of a client while serving as a director of that company.)	Guilty of violating independence rule. Suspended for six months. Name not mentioned in The CPA. Effective 4/15/71.
7)	3/16/71		Act discreditable to the profession. Convicted of willfully delivering or disclosing false document to Secretary of Treasury, a misdemeanor.	Guilty as charged. Suspended for six months. Name not mentioned in The CPA. Effective 4/15/71.
8)	5/71		Conviction of crimes involving moral turpitude-mail fraud and conspiracy in violation of Art. V, Section 5.	Guilty as charged. Expelled. Name not mentioned in The CPA.
9)	5/71		Same	Same
10)	5/71		Same	Same
11)	5/07/71	David B. Barash	Bribery in violation of 18 USC 201(b) (f), 26 USC 7214(a) (2)	Guilty as charged. Name mentioned in The CPA.
12)	5/08/71	Robert L. McGee	Revocation of CPA certificate (Art.V, Sec. 4(f) (Art.VII, Sec.7.4.5)	Expelled. Name mentioned in The CPA. Effective 5/7/71.
13)	7/71	Dean C. Byrd	Advertising and solicitation.	Guilty as charged. Expelled. Name mentioned in The CPA.

Page 10, Exhibit 2

	DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
14)	7/15/71		1) Convicted of crimes involving moral turpitude. (Fraud in sale of securities, mail fraud and conspiracy 15 USC 77 q.(a); 18 USC 1341, 371 (Art.V, Sec. 5) 2) Committed act discreditable to profession in failing to resign as employee of a corporation knowing it was engaged in illegal practices. (Rule 1.02)	Guilty as charged in number 1. No finding on number 2. Expelled. Name not mentioned in The CPA. Effective 8/14/71.
15)	7/15/71		Act discreditable to the profession (willfully delivering to the Commissioner of Internal Revenue false tax return, a misdemeanor) (Art. 7, Sec. 7.4 (3).	Guilty as charged. Suspended for one year. Name not mentioned in The CPA. Effective 8/14/71.
16)	7/22/71	Charles L. Ciaccio	Bribing IRS official - conviction of a crime involving moral turpitude.	Expelled. Publication of name in The CPA. Effective 8/21/71.
17)	7/22/71	Jack Greenberg	Bribing IRS employee & aiding in preparing false tax returns.	Guilty as charged. Expelled. Name mentioned in The CPA.
18)	7/22/71	Joseph J. Seaman	Convicted of misconduct in office, unlawfully conspiring to violate N.J. law, receiving a fee not allowed by law in violation of Art. V,Sec.5.	Guilty as charged. Expelled. Name mentioned in The CPA.
19)	7/23/71	S. George Burris	Convicted of a crime involving moral turpitude (fraud by mail & wire & conspiracy to defraud). (Art. V, Sec. 5)	Guilty as charged. Expelled. Name mentioned in The CPA. Effective 8/22/71.
20)	7/23/71		CPA certificate suspended - alleged to have withheld client records and to have lied to state board.	Admonished. Name not mentioned in The CPA. Effective 8/22/71.

Page 11, Exhibit 2

	DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
21)	7/23/71	Everett A. Whorl	1) Convicted of violating 15 USC 78ff(a) and 78g (Art. V, Sec. 4(d) 2) Convicted of conspiring to defraud the SEC in 15 USC 78m and 78ff(a) (Art.V, Sec. 4(d) and 5)	Guilty as charged. Suspended for two years. Guilty as charged. Expelled.
			3) Convicted of violating 15 USC 78m and 78ff (a) (Art. V, Sec. 5)	Guilty as charged. Expelled. Name mentioned in The CPA.
22)	3/08/72		Materially negligent in conduct of examination or reporting thereon; failure to acquire sufficient information to warrant expression of opinion.	Guilty. Suspended for 6 months with publication of name in The CPA.
23)	3/28/72	William Lichtenberger	Materially negligent in conduct of examination or reporting thereon; failure to acquire sufficient information to warrant expression of opinion; lack of independence.	Guilty. Expulsion with publication of name in The CPA.
24)	3/28/72		Materially negligent in conduct of examination or reporting thereon; failure to acquire sufficient information to warrant expression of opinion; failure to direct attention to material departure from GAAP or to disclose material omission of generally accepted auditing procedure applicable in circumstances.	Guilty. Admonished. Name not published in The CPA.
25)	4/05/72	Jerome Olson	Conviction of a crime involving moral turpitude based on nolo contendere plea to violation of the securities acts.	Guilty. Expelled with publication of name in The CPA.
26)	4/05/72	Donald Warden	Act discreditable in failure to return books and records of a client on demand.	Guilty. Expelled with publication of name in The CPA.

Page 12, Exhibit 2

	DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
27)	4/28/72		Act discreditable in view of SEC allegation of various violations of the Security Act of 1933 and the Securities and Exchange Act of 1934.	Not guilty.
28)	4/29/72	Max Forman	1) Suspension of CPA certificate by Florida State Board.	Guilty.
			2) Act discreditable based upon underlying facts leading to the Florida suspension.	Not guilty.
			3) Violation of Rule 202 in connection with financial statements of Texas Uranium Company, 9/25/68.	Guilty. Suspended for 3 months with publication of name in The CPA.
29)	8/16/72	Jules Spaulder	Act discreditable in that he ordered large blocks of new issue stocks for his own account without paying for them.	Guilty; admonished; with publication of name in The CPA.
30)	8/16/72		Act discreditable in that he made an unlawful payment to official of State Board under the misrepresentation of the said official that same was required for respondent to have been recorded as having passed the state CPA exam.	Guilty; admonished; no publication of name in The CPA.
31)	8/17/72	Albert Koska	Criminal conviction (T 18 U.S.C. sect. 201(b) as violation of Article V, Section 5 of bylaws in effect in 1966.	Guilty; expulsion; with publication of name in The CPA.
32)	8/17/72		Violation of advertising & solicitation Rule 3.01 by means of telephone directory listings, newspaper advertisements and improper signs.	Guilty; admonished; no publication of name in The CPA.
33)	8/17/72	Jack Jacobs	Criminal conviction (T26 U.S.C. Section 7207) as violation of Article VII, Section 7.4(.3) of current bylaws.	Guilty. Suspension for 2 years with publication of name in The CPA.

Page 13, Exhibit 2

	DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
34)	8/22/72	Goodrich F. Cleaver	Violation of Rule 2.02 in connection with financial statements of Picture Island Computer Corporation dated 6/30/71.	Guilty. Expulsion with publication of name in The CPA
35)	8/22/72	Edward C. Wirotzious	Act discreditable in that he was removed as Administrator CTA of defendent's estate by state Probate Court for self dealing.	Guilty. Suspension for 1 yr. with publication of name in The CPA.
36)	10/72	Phillip E. Corey	Convicted of violation of Rule 1.02 - act discreditable. Unlawfully converted to his own use substantial monies which were property of others by means of forgeries & maintenance of improper bank accounts.	Guilty. Expelled, with publication.
37)	12/14/72	David Wenger	Convicted of filing false & fraudulent federal income tax returns & of conspiring to violate the federal anti-kickback statutes.	Guilty as charged, with publication of name. Expelled.
38)	5/22/73		Violation of Rule 1.02, an act discreditable to the profession, by misstating the date on his client's income tax return.	Not guilty.
39)	5/22/73		Violation of Rule 4.05, advertising.	Not guilty.
40)	12/6/73	Roy I. Schwartz	Act discreditable (bribery of public officials); convicted of violation of Art. VII, Section 7.4 (.3) (moral turpitude)	Guilty as charged with publication of name.
41)	12/06/73	Ewart M. Galvin	Act discreditable (failure to file personal federal income tax return; convicted of violation of Art. V, Section 5 (moral turpitude).	Guilty as charged with publication of name.

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DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
42) 12/17/73		Violation of Rules 202 and 203 relating to compliance with auditing and reporting standards.	Guilty; admonishment.
43) 12/17/73		Violation of Rules 202 and 203 requiring adherence to standards relating to auditing and accounting principles.	Guilty; admonishment.
44) 4/29/74		Violation of Rule 202(a) in failing to disclose material facts in report on financial statements.	Not guilty. No mention of name in publication.
45) 4/29/74		Same	Guilty. Admonished. Publication with no mention of name.
46) 7/12/74		1) Violation of Rule 202(c). Technical Standards-Auditing 2) Violation of Rule 101. Independence 3) Violation of Rule 202(d) Technical Standards-Auditing	Not Guilty. Guilty. Guilty - Suspended for 1 yr. No name in publication.
47) 7/12/74		Same	Same
48) 49) 9/04/74		Violation of the commission rule in effect from 1957 through 1967 and act discreditable to the profession by accepting commissions in violation of the commission rule.	Not guilty.

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DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
50) 9/23/74 51)		1) Materially negligent in making a report on financial statements being audited. 2) Materially negligent in the conduct of an audit examination. 3) Materially negligent in failing adequately to plan the work performed in connection with the examination and properly supervising the assistants on the engagement. 4) Failure to exercise the due care which would have discovered the aggregate deficiencies in the subordinate's performance.	1) Not guilty. 2) Not guilty. 3) Guilty. Admonished without publication of notice. 4) Not guilty.
52) 3/19/73		Conviction of crime involving moral turpitude.	Not guilty.
53) 3/19/73		Act discreditable in relation to false and fraudulent financial statements. Pled guilty to misdemeanor charge under 10b5.	Not guilty.
54) 11/11/74		Violation of Rule 101 in having a direct financial interest in a client on whose financial statements an opinion was expressed.	Guilty; admonishment with no publication of name.
55) 11/11/74		Same	Same
56) 11/11/74		Same	Same
57) 11/11/74		Act discreditable in having been found by a state board of accountancy to have knowingly and intentionally submitted false, inaccurate & misleading financial statements; violation of Rule 202 (a) (b) (c) (d) and (e).	Guilty, expulsion with publication of name.

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DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
58) 11/11/74	David Frey	Violation of Rule 202 in failing to acquire sufficient information and in failing to keep adequate workpapers. Act discreditable to the profession in failing to comply with the direction of the Institute's Trial Board at a 1972 hearing to adhere to professional standards. (A number of other charges were made and found not to be sufficiently supported by the evidence.	Guilty; expulsion with publication of name.
59) 11/18/74	Jerry A. McFarland	Violation of Rule 202 (a) (b) (c) (d) and (e); act discreditable to the profession in having been permanently enjoined from further violations of the securities acts.	Guilty of 202 (a)(b)(c) & (e). Not guilty on act discreditable (A member does not "commit" an act discreditable when he is the subject of an injunction Expulsion with publication of name.
60) 3/10/75		1) Violation of Rule 202(c)(d) & (e). Act discreditable to the profession in having been permanently enjoined from further violations of the securities acts and in having consented to a 1-year suspension from practice before the SEC. 2) Violation of Rule 202 (c), (d) and (e) in connection with client's financial statements.	1) No finding on act discreditable. 2) Guilty of 202 (c)(d) & (e). Member suspended for 2 years beginning 5/31/76. Sentence suspended until that time and if member completes specified CPE courses by that time, suspension will not take effect. No mention of name.
61) 11/28/75		1) Conviction of criminal offense tending to discredit the accounting profession (violation of bylaws Section 7.4.3). 2) Conviction of crime involving moral turpitude (violation of bylaw Section 7.4.3). 3) Acts underlying conviction constitute acts discreditable to the profession violating Rule 102 of the Code. 4) Acts underlying conviction constitute acts discreditable to the profession violating bylaws Section 7.4.3. 5) Convictions of crime which constitute declaration by a court of fraud having been committed in violation of bylaws Section 7.4.2.	1) Not guilty. 2) Not guilty. 3) Not guilty. 4) Not guilty. 5) Not guilty.

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DATE	INDIVIDUAL	CHARGE	PUNISHMENT RENDERED
62) 10/12/75		1) Solicitation by letter in violation of Rule 502 of Code. 2) Indication of specialty in violation of Rule 505 of Code.	Guilty on both counts. Suspended for 6 months - suspension stayed if home study course on professional ethics is completed with a grade of 90 or above by 1/1/76. Publication without name.
63) 10/12/75	Erwin Wagner	1) Participating in bribe of IRS agent in violation of Article V, Section 4d of bylaws. 2) Act discreditable to the profession in participating in bribe in violation of Rule 102 of Code and bylaw Article V, Section 4d.	Guilty as charged. Suspended for two years. Publication with name.

Case No.	"Subsequent Actions" Re the Above
3.	Application for reinstatement pending.
8.	Reinstated to membership based upon a presidential pardon.
9.	Reinstated to membership based upon a presidential pardon.
10.	Reinstated to membership based upon a presidential pardon.

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Case No.	"Subsequent Actions" Re the Above
11.	Reinstated to membership by AICPA Trial Board.
15.	Reinstated by virtue of end of term of suspension.
22.	Found not guilty on appeal to full AICPA Trial Board.
25.	Application for reinstatement pending.
28.	Reinstated.
31.	Application for reinstatement pending.
50.	Found not guilty on appeal to full AICPA Trial Board.
51.	Found not guilty on appeal to full AICPA Trial Board.
57.	Full AICPA Trial Board affirmed guilty finding on appeal, but reversed publication of his name.

Page 19, Exhibit 2

The Rules of Conduct are also enforced by the Institute in several other ways.

The ethics division, which receives complaints against members may, following an investigation of the complaint, issue a letter of constructive criticism and close the file. This action is not a disciplinary action as such and is merely an expression by the committee that, while no serious violation appears to have taken place, the preferable course of action would have been as indicated in the letter of criticism.

Although we do not believe the question seeks information about less formal actions than trial board decisions, the professional ethics division can also issue letters of administrative censure with respect to cases where it has found a minor violation which does not appear to warrant convening a trial board hearing panel. There is no provision for publication of these actions and a member receiving an administrative censure can request that the trial board adjudicate the ethics division's conclusion and action.

Although administrative censures are not trial board actions and are considered private we are including for your information the number and type of such actions since 1970:

1970 -	Solicitation and Advertising	13	
	Acts Discreditable	1	
			14
1971 -	Solicitation and Advertising	9	
	Acts Discreditable	1	
			10
1972 -	Solicitation and Advertising	12	
	Acts Discreditable	1	
	Auditing Standards	7	
			20
1973 -	Solicitation and Advertising	7	
			7
1974 -	Solicitation and Advertising	11	
	Commissions	3	
	Independence	3	
	Auditing Standards	7	
	Acts Discreditable	2	
			26
1975 -	Solicitation and Advertising	14	
	Auditing Standards	14	
	Independence	1	
	Acts Discreditable	3	
			32
1976 -	Auditing Standards	1	
			1

As a part of the imposition of administrative censures, the division since 1972, can mandate that the member take continuing professional education courses, and this was done in 23 cases.

Attachment 2-1

The Joint Ethics Enforcement Plan

Structure and Stated Purpose

Attached is a simplified representation of the organization and procedure of the joint ethics enforcement plan.

The plan, which went into effect on August 1, 1975, was developed by AICPA and state society leaders to achieve these aims:

- Improve the profession's self-regulation, particularly technical standards enforcement and to develop statistics on the true state of ethics enforcement.

- To eliminate the duplication of AICPA and state society efforts by (a) linking the procedures of the state societies ethics committees with the procedures of the AICPA's ethics committees, and (b) empowering joint trial board panels to take disciplinary action which would at one time affect the AICPA and state society memberships of a CPA member of both or either.

- To regularize the profession's support of ethics enforcement by state accountancy boards so as to affect the right to practice. While not affecting a state board's right to proceed independently, the plan's procedures envision that a joint trial board panel may direct, if appropriate, that the ethics committee submit a well-documented hearing record as a complaint to the state board. In less serious matters concluded short of being referred to a joint trial board hearing panel, the investigation file of the AICPA or state society ethics committee would be available to the state board upon request.

Operation of Joint Plan

Complaints are received by the division from the public, professionals, government agencies at all levels and state society ethics committees. The plan envisions that an initial determination will be jointly made with the participating state society ethics committee on each matter as to whether it involves issues of broad national concern, multi-state jurisdiction or litigation. In any such matters the AICPA ethics division will retain direct control over the investigation; if not, the state society will investigate on behalf of the profession using such assistance from the AICPA as is desired. At the conclusion of the investigation a joint decision is made to close without action, issue a letter of constructive criticism (not a disciplinary action), issue an administrative censure (a disciplinary action) or find a prima facie case for presentation to the Regional Trial Board system as outlined on the reverse side.

ENFORCEMENT PROCEDURE

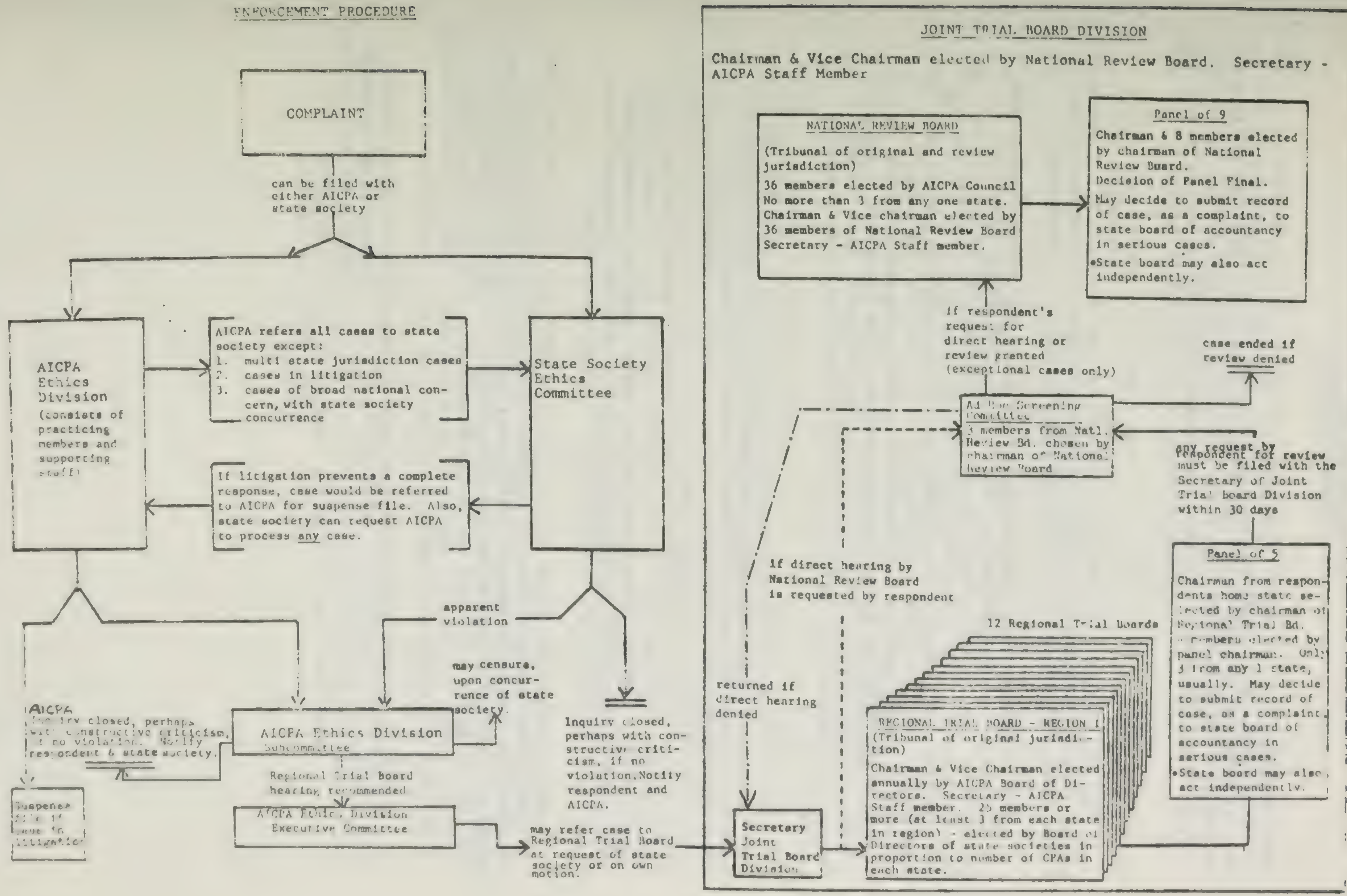

Exhibit 3

Question No. 3:

"an explanation of the role of the AICPA in developing and administering the Uniform Certified Public Accountant examination, along with a description of the examination and its application;"

Response:

The role of the AICPA with respect to the Uniform CPA Examination, stated in simplest terms, is to prepare the examination and to offer advisory grades to the 54 boards of accountancy using it.

The AICPA prepares the examination booklets and provides them to the boards of accountancy. The boards throughout the country administer the various sections of the examination at a uniform time and then return the completed examination papers to the Institute for grading. The papers are coded by the individual boards and the identity of the candidate completing the paper is not known to the Institute. The grading is completed and the papers returned to the boards with advisory grade reports in time for boards to communicate grades to the candidates on a uniform announcement date which is set at approximately three months after the examination is actually administered.

The Uniform CPA Examination traces its origin back to the early 1900s when it was used as a requirement for membership in the national accounting society which eventually became the AICPA. In 1917 four boards of accountancy began to use the examination as their professional licensing examination and by 1962 all 50 states, Guam, Puerto Rico, the Virgin Islands and the District of Columbia had likewise adopted it. As a result, the CPA certificates of all jurisdictions are on substantially the same footing, a condition which has enhanced the national prestige of the CPA designation and has aided the interstate practice of public accounting.

The primary objective of the Uniform CPA Examination is to test the candidates' competence in the application of technical skills required in the practice of public accountancy, including accounting, auditing, taxation and management consulting. Such professional quality includes adequate technical knowledge, the ability to apply such knowledge skillfully and with good judgment, and an understanding of professional responsibility.

Although in its theoretical foundations and practical applications accounting draws upon related areas, the discipline of accounting is defined to include financial accounting, managerial accounting,

auditing, business law, and federal income taxation. The content of the examination changes as conditions change in the discipline of accounting. It is possible, however, to indicate the general content of the examination and the knowledge and skills which are typically tested. Candidates may expect the examination to measure the extent of their knowledge of the following:

(a) Accounting standards, concepts, postulates and principles.

(b) Generally accepted auditing standards, audit programs, and auditors' reports.

(c) Business organization and operation, including a knowledge of the basic laws governing such organization and operation.

(d) Use of accounting data for managerial purposes.

(e) Quantitative methods and techniques as they apply to financial and managerial accounting and auditing.

(f) Cost behavior, systems, and computer fundamentals.

(g) Federal income taxation.

(h) Accounting for governmental and not-for-profit organizations and related concepts, procedures, and reports.

(i) Professional ethics.

(j) Current professional literature and accounting issues receiving special attention at the time of the examination.

Candidates are expected to demonstrate their ability to apply to specific situations their knowledge of the foregoing areas with good judgment and logical reasoning, and to draw reasonable conclusions from such applications. In addition, the examination enables candidates to show the extent of their ability to:

(a) Write precisely and concisely, and in good English.

(b) Organize accounting data and present them in acceptable form.

(c) Examine data in a complex situation, and evaluate and classify such data.

Page 3, Exhibit 3

(d) Apply appropriate accounting standards, concepts, and auditing procedures to given situations.

(e) Use with reasonable facility other disciplines related closely to the discipline of accounting, such as quantitative methods, statistics, finance, economics, marketing, and behavioral science.

The foregoing subject matter is covered in the four sections of the examination entitled Accounting Theory, Accounting Practice, Auditing and Business Law. The entire examination is two and one-half days in length and may be taken entirely at one time or in separate segments, depending upon the rules and requirements of the particular board of accountancy administering the examination.

Each examination is composed of new material. A complete examination is administered in May and November of every year. Candidates are permitted to retain their test booklets, and the answers used to grade the examination are published.

A copy of our booklet "Information for CPA Candidates" is enclosed. It provides a more detailed description of the preparation and contents of the examination and how it is graded.

In the interest of assuring ourselves that the examination is appropriate and effective, testing consultants have been retained on a continuing basis and on several occasions experts have been engaged to review, evaluate and constructively criticize our handling of this important function.

Exhibit 4

Question No. 4:

"a listing of the periodicals published by the AICPA, including a description of the purpose, cost, and circulation of each;"

Response:

Journal of Accountancy (monthly)

Purpose: To publish technical accounting articles that will be of interest to all major segments of the profession -- public accountants, auditors, general tax practitioners, MAS specialists, educators, corporate financial officers and others. The objective of the Journal is not only to inform but to provide a forum for the issues confronting the profession.

Cost: The Journal goes without charge to all AICPA members. Others may subscribe at $15 a year ($1.50 a copy). Student rate: $7.50.

Circulation: About 200,000 (including 120,000 members).

The Tax Adviser (monthly)

Purpose: To keep professional tax practitioners apprised of the latest developments in federal income, gift and estate taxation, including new legislation, IRS rulings, court decisions and tax planning techniques.

Cost: $36 a year ($3.25 a copy); $28 for AICPA members.

Circulation: About 11,000.

The CPA Letter (22 issues a year)

Purpose: To serve as an alert to members regarding developments in professional standards and in other technical areas. The CPA Letter is also the Institute's membership bulletin, in which policies and activities are reported.

Cost: Free to all members. $25 a year to others.

Circulation: To all members (120,000) and over 300 paid subscribers.

Page 2, Exhibit 4

State Society Coordinator (10 issues a year)

Purpose: To inform the profession's leaders of current projects and programs of the AICPA and of the state CPA societies and chapters.

Cost: No charge.

Circulation: About 2,500.

Washington Report (Weekly)

Purpose: To report on federal agency and congressional activities of interest to the accounting profession -- an overview of Washington news of importance to accountants.

Cost: $38 a year ($30 to AICPA members).

Circulation: Over 600 total.

Although the question asked only for information relating to periodicals published by the AICPA, the Institute is a major publisher of technical accounting literature. A copy of the current publications catalogue is attached for information.

Exhibit 5

Question No. 5:

"a list of the members on each of the five advisory committees mentioned on page 43 of the 1975-76 AICPA Committee Handbook, along with a list of meetings held and recommendations made by each group since 1 January, 1974;"

Response:

Group A Advisory Committee

Meetings held since January 1, 1974:

The first meeting was held on September 9, 1975. Since then, four other meetings have been held.

Group A has recommended:

- Modification to the draft program for quality control review of firms.
- Maintenance of existing program of notifying members of FASB pronouncements by publication in the Journal of Accountancy rather than individual mailings to members.
- Formation of a group to study application of GAAP to small business.
- Better communication from the Institute to local practitioners.
- Communication to the FASB of the concept that any FASB statement requiring disclosure of supplemental price level information should be applicable, at least, initially, only to business entities filing financial statements prepared in accordance with GAAP with the SEC or other regulatory agencies having jurisdiction over public companies.
- A program of member forums with discussion materials prepared by the Institute which will enable interested local practitioners to discuss issues of current interest.
- Revision of the auditors' report to provide levels of assurance to replace the present "clean" opinion, qualified opinion and disclaimer of opinion.

Page 2, Exhibit 5

- That there is only one set of generally accepted accounting principles and the same principle of measurement applies to all engagements; therefore, the profession should establish minimum disclosure standards with additional disclosure required depending on the nature of the engagement and the needs of users.

- That as many qualified local practitioners as possible be offered committee service.

and in addition, the Group:

- Provided informal comment on various exposure drafts of proposed ethics interpretations.

- Endorsed the Institute's publications effort and requested development of more practice-oriented material in the Journal of Accountancy.

- Endorsed a proposal for the development of a newsletter which could be purchased from the Institute and sent to clients.

Group B Advisory Committee

Meetings held since January 1, 1974:

The first meeting was held on September 19, 1975. The committee has held two additional meetings.

Group B has recommended:

- Modifications to the proposed program of quality review of firms and later endorsed the final proposal.

- Adoption of the program for response by lawyers to letters of inquiry by auditors which had been worked out between representatives of the ABA and the Institute.

- To the auditing standards executive committee that in any statement on illegal acts by clients, the auditors' responsibilities should be drawn as narrowly as practicable.

- That the position taken by the SEC in ASR 177 that an auditor must opine on the preferability of accounting principles when a client has adopted a change to an alternate principle be opposed.

Page 3, Exhibit 5

- That there be greater representation of Group B firms on Institute committees and task forces and suggested ways this could be accomplished.

- Adoption of a program on how to provide greater opportunity for recruitment and advancement of minorities in medium size firms.

- Development of a client informational newsletter for sale by the Institute and subsequent mailing to clients.

Group C Advisory Committee

Meetings held since January 1, 1974:

Representatives of a number of larger firms met in January, 1975 to consider whether ways could be found to streamline the effort to resolve technical issues encountered in practice. The group decided to support a proposal that advisory committees be formed, composed of representatives of key elements of the profession. Three other informal meetings of this group were held and in September of 1975, the first meeting of Group C Advisory Committee was held. Seven subsequent meetings of Group C have been held.

Group C has recommended:

- That advisory groups be formed to promote adoption of more uniform standards on a timely basis so as to make available more meaningful comparisons of financial information and thus to promote public confidence in the profession.

- That the AICPA provide, through its Accounting Standards Division, machinery to alert the FASB to emerging problems in practice and to provide to the profession interim guidance on emerging practice problems when the FASB cannot respond in a timely manner.

- That the Accounting Standards Division should be assisted by task forces which could input to the FASB with the concurrence of the division chairman on proposed FASB pronouncements.

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Page 4, Exhibit 5

- That the Auditing Standards Division defer issuance of a standard that would require disclosure of deviations between U. S. standards and those proposed by the International Accounting Standards Committee until the full implications of such a requirement and its impact on confidence in domestic standards could be ascertained.

- That the Auditing Standards Division issue a statement regarding interim reporting that would define the minimum scope of a limited current review; permit the issuance of a report solely for use of management and the board of directors; and require, as a condition of accepting such engagements, an undertaking that the client will not publish the report.

- That the board of directors endorse harmonization of international accounting standards through the International Accounting Standards Committee.

- That the accounting standards executive committee publish a position paper on marketable equity securities in the event the FASB did not deal with the issue on a timely basis.

- Adoption of the program for review of quality control standards for firms with SEC practices.

- A study to define options available to seek a reasonable measure of relief from unreasonable litigation and the limitless legal liability presently imposed on accounting firms.

- Against creation of a political action committee.

Educators Advisory Committee

Meetings held since January 1, 1974:

The first meeting was held on November 3, 1975. Since then, one other meeting has been held.

The Group has recommended:

- Greater educator participation on the Auditing Standards Executive Committee.
- Strong support for programs and schools of professional accounting.

Industry and Government Advisory Committee

Meetings held since January 1, 1974:

The first meeting was held on October 24, 1975. Since then, three other meetings have been held.

The Group has recommended:

- Greater communication with industry and government people through regional conferences and CPE courses.
- Topics of interest to the group for the annual meeting technical program.
- Greater involvement in committee activities of the Institute by industry and government members, and offered suggested procedures to achieve that end.
- Elimination of the bylaw requirement that Institute officerships and trial board memberships be held by members in public practice.
- A national conference for members in industry and government.
- That the Institute support service by CPAs not in practice on state boards of accountancy.

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* * * * * *

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* * * * *

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1975-76

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Arthur Schoenhaut	Cost Accounting Standards Board (202) 386-6213	441 G Street, N.W. Washington, D. C. 20548
John L. Wedick, Jr.	Internal Revenue Service (202) 964-4046	1111 Constitution Avenue, Room 2501 Washington, D. C. 20224
Stanton E. Wilson	Monroc, Inc. (801) 359-3701	Box 537 Salt Lake City, Utah 84110

* * * * * *

Staff Aide: William C. Bruschi, Vice President-Research & Review

Exhibit 6

Question No. 6:

"a description of the Commission on Auditors' Responsibilities, including the backgrounds and manner of selection of its members, and the amounts contributed directly or indirectly for its support;"

Response:

Description of Commission

The Commission on Auditors' Responsibilities is an independent body established by the American Institute of Certified Public Accountants to conduct a study concerning the responsibilities of independent auditors in light of the needs and reasonable expectations of society.

The Institute, concerned about the challenges which had been made to the profession's role as independent auditors, convened a meeting of leaders of the profession in 1974 to consider what might be done to deal with those challenges. The group recommended the creation of a seven-man independent commission to conduct a study of the responsibilities of independent auditors and to recommend actions that the organized profession could take to assure that independent auditors discharge adequately and effectively the responsibilities reasonably assigned to them. Accepting the recommendation of the group, the Board of Directors of the American Institute of Certified Public Accountants established the Commission on Auditors' Responsibilities and gave it the following charge:

> In the broadest sense, the function of independent auditors is to enhance the reliability of information used in financial decisions of a wide range of individuals and organizations. This role is an important aspect of the process of efficient allocation of resources in the economy. Therefore, it is vital to the economy that users of information have confidence in auditors. Such confidence is dependent on a mutual understanding as to the appropriate responsibilities of auditors and a belief by users that such responsibilities are being fulfilled.
>
> In view of the growing demands by investors, creditors, management, government, and the general public for auditors to assume a wider scope of responsibility, the American Institute of Certified Public Accountants has concluded that a full-scale study should be made of the future function of independent auditors.

Page 2, Exhibit 6

The main purpose of the study is to develop conclusions and recommendations regarding the appropriate responsibilities of independent auditors. It should consider whether a gap may exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish. If such a gap does exist, it needs to be explored to determine how the disparity can be resolved.

Some of the specific questions being asked by the public are, What responsibility should an auditor have for detecting fraud? Should auditors monitor all financial information released to the public and if so, what should be the extent of their responsibilities? Should the auditor's standard report, particularly the phrase "present fairly," be changed to express better the responsibilities of auditors? What mechanisms should be adopted to strengthen the function of auditors? Is the mechanism for developing auditing standards adequate? What should the profession do to reduce the risks of misunderstanding about its role?

In considering such questions, the study should recognize that the responsibilities of auditors may be constrained by the nature of the information presented, the evidence that exists to support that information, the effectiveness of the methods of acquiring that evidence, and the costs of collecting and analyzing the information. In developing the feasible responsibilities of auditors, resposibilities should not be confused with results. Recognizing a responsibility does not necessarily imply infallibility in execution.

The study should obtain the views of as many interested and knowledgeable parties as is possible and should assure that the views obtained are representative of users and providers of independent audits as well as providers of financial information. One or more public hearings should be held. A public record should be maintained of significant proceedings of the study and of comments received.

The Commission has taken a comprehensive view of the problem with which it was presented. Since its initial charge was stated in broad general terms, the Commission found it necessary to elaborate

the charge. For that purpose, the Commission has previously published and widely distributed a booklet, Statement of Issues: Scope and Organization of the Study of Auditors' Responsibilities, a copy of which is enclosed.

Manner of Selection and Backgrounds of Members

The seven members of the Commission were appointed by the Chairman of the American Institute of Certified Public Accountants from among individuals from within and outside of the profession who were known to have backgrounds and experience which could be brought to bear on the charge assigned to the Commission. A majority of the members are not professional auditors.

The members are:

Manuel F. Cohen, Chairman

Mr. Cohen is a securities lawyer. After working in his own practice, he was employed by the Securities and Exchange Commission in 1942. He served on the Commission from 1961-1969 and as its chairman from 1964-1969. He is presently a partner in Wilmer, Cutler & Pickering, attorneys in Washington, D.C. He is a member of the American Bar Association, Federal Bar Association, District of Columbia Bar Association, American Law Institute, American Society of International Law, and other organizations. He is an adviser to the American Law Institute and an adviser concerning securities market matters in various countries. He has authored publications in legal and business journals in the United States and abroad.

Walter S. Holmes, CPA

Mr. Holmes is a business executive. He received a B.S. degree from Lehigh University in 1941 and holds a degree from New York University Graduate School of Business. He joined C.I.T. Financial Corporation as assistant controller in 1959 and is currently the chief executive officer and chairman of the board of that company. He is a director of several large companies. He is a member of the Financial Executives Institute and of the American Institute of Certified Public Accountants.

Page 4, Exhibit 6

LeRoy Layton, CPA

Mr. Layton is a certified public accountant. He recently retired from practice as senior partner of Main Lafrentz & Co., a public accounting firm. He received a B.S. degree in commerce from Drexel University in 1937. He is a former president (a position now designated as chairman of the board) of the American Institute of Certified Public Accountants and a former chairman of its Accounting Principles Board. He is a member of the state societies of CPAs of New Jersey, New York, and Pennsylvania and of the American Accounting Association. He is active in the Boy Scouts of America and as a member of the Board of Trustees of Drexel University.

William C. Norby

Mr. Norby is a financial analyst. He is a graduate of the University of Chicago. He joined the Harris Trust and Savings Bank in Chicago in 1935 and served as senior vice president from 1964 to 1970. He is presently senior vice president of a Chicago-based firm of investment analysts and advisors, Duff and Phelps, Inc. He is a member of the Financial Analysts Federation and served as executive director of that organization from 1970 to 1973.

Lee J. Seidler, CPA, Ph.D

Mr. Seidler is an educator. He received A.B., M.S., and Ph.D degrees from Columbia University. He is presently a professor of accounting at New York University and a business analyst and consultant. He has an association with Bear Stearns, Inc. securities brokers and serves as a consultant to a number of institutional investors, corporations, and accounting firms. Earlier in his professional career, he worked on the audit staff of Price Waterhouse and Co., a public accounting firm, in New York and Paris. He is a member of the American Institute of Certified Public Accountants, the American Accounting Association, and the New York Society of Certified Public Accountants. He is the author of two books and many publications in professional accounting and business journals.

Page 5, Exhibit 6

Kenneth W. Stringer, CPA

Mr. Stringer is a practicing certified public accountant. He received a B.S. degree in commerce from Western Kentucky State College in 1938. He was a partner in the public accounting firm of Killebrew & Stringer from 1946-1952. He is presently the senior technical partner in the public accounting firm of Haskins and Sells in New York. He is a member of the American Institute of Certified Public Accountants, the American Accounting Association, and the American Society of Accountants. He has been active in the AICPA as a member of its accounting standards executive committee and related task forces from 1972-1974.

John J. van Benten, CPA

Mr. van Benten is a practicing certified public accountant. He received a B.S. degree from the University of Notre Dame in 1944. He is presently the managing partner of the public accounting firm of George S. Olive & Co. in Indianapolis, Indiana. He is a member of the American Institute of Certified Public Accountants and the Indiana Association of CPAs. He served as a member of the tax committees of the AICPA and the Indiana Association. He is a trustee of the Marion County Health & Hospital Corp. and of St. Vincent Hospital. He is a member of the board and president of the Indiana State Symphony Society.

Staff and Consultants

The staff of the Commission is under the direction of Douglas R. Carmichael, CPA, Ph.D. Mr. Carmichael is managing director of the technical divisions of the American Institute of Certified Public Accountants. Other members of the staff and their affiliations are as follows:

Staff

George de Mare, Editor
AICPA
Eugene F. DeMark, CPA, Researcher
Peat, Marwick, Mitchell & Co. (a public accounting firm)
Ann Gabriel, CPA, Researcher
Coopers & Lybrand (a public accounting firm)
Leonard Lorensen, CPA, Researcher
AICPA

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Patricia A. McConnell, Researcher
New York University
Thomas W. McRae, CPA, Researcher
AICPA
Paul Rosenfield, CPA, Researcher
AICPA
Robert Temkin, CPA, Researcher
Arthur Young & Co. (a public accounting firm)
Brian Zell, CPA, Researcher
AICPA

Consultants

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University of North Carolina
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Professor Henry R. Jaenicke
Franklin & Marshall College
Professor John G. Rhode
University of California, Berkeley
Professor Melvin Shakun
New York University
Professor Jeremy Wiesen
New York University

Amount Contributed for Support

All expenses for the support of the Commission are borne by the American Institute of Certified Public Accountants. The following is a tabulation of expenses incurred or allocated through April 1976 and of amounts budgeted through July 1977.

	Actual			Budgeted	
Direct	1974-75	1975-76 (9 mos.)	Total	1975-76 (3 mos.)	1976-77
Salaries	$ 30,717	$ 16,024	$ 46,741	$ 21,776	$ 29,500
Fees	30,957	63,726	94,683	37,274	113,500
Other	56,711	32,384	99,095	46,566	141,010
	$118,385	$112,134	$230,519	$105,616	$284,010
Allocated*	3,253	97,688	100,941	n.a.	n.a.
Totals	$121,638	$209,822	$331,460		

*Allocated from other divisions of the Institute, primarily the technical research division.

The amounts shown do not reflect the gratis time contributed by most members of the Commission and by public accounting firms that have loaned staff to the Commission.

May 27, 1976

Exhibit 7

Question No. 7:

"a list of those trustees of the Financial Accounting Foundation, FASB members, and FASB Advisory Committee members who are also members of the AICPA."

Response:

Financial Accounting Foundation Trustees:

Richard T. Baker
John C. Biegler
Ivan O. Bull
James Don Edwards
William H. Franklin
Ralph E. Kent
Stanley J. Scott
Wilbert A. Walker

Financial Accounting Standards Board Members:

Marshall S. Armstrong
Oscar S. Gellein
Donald J. Kirk
Arthur L. Litke
Robert E. Mays

Financial Accounting Standards Advisory Council:

Marshall S. Armstrong
Andrew Barr
Norton M. Bedford
George R. Catlett
Joseph P. Cummings
J. O. Edwards
Charles G. Gillette
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Charles T. Horngren
Harold Q. Langenderfer
Raymond C. Lauver
Robert K. Mautz
David Norr
E. Palmer Tang
Allan Wear
Charles A. Werner

Exhibit 8

Oral Question from Jack Chesson:

"Describe the relationship Mr. Andrew Barr had with the AICPA while a consultant."

Response:

Following his retirement as chief accountant at the SEC, Andrew Barr was engaged on June 16, 1972 as a consultant to the Institute and its members. His compensation was at $30,000 a year. It was expected that his hours would be no more than half a normal employee working schedule. The arrangement was for one year, renewable by mutual agreement.

Mr. Barr was expected to consult with small firms threatened with displacement when a client had a public offering of securities, to advise the displacement committee, to assist in developing a guide to SEC practice for smaller firms and to advise them on a case by case basis on problems arising in connection with SEC work. He was also expected to consult with the AICPA ethics committee and other technical committees where his broad talents could make a contribution.

Effective November 1, 1974 his compensation was changed to $3,000 per quarter and he ended his consulting activities with the AICPA on December 31, 1975.

Exhibit 9

Oral Question from Jack Chesson:

"How much money did the AICPA pay for its last audit."

Response:

The Institute paid $34,500 for work in connection with its last audit.

Report of Independent Certified Public Accountants

From AICPA's Annual Report, 1975

To the Members of the American Institute of Certified Public Accountants

We have examined the statement of assets, liabilities and fund balances of the American Institute of Certified Public Accountants as of July 31, 1975 and 1974 and the related statements of revenues and expenses, changes in fund balances, and changes in financial position for the years then ended. We have also examined the statements of assets, liabilities and fund balances of the American Institute of Certified Public Accountants Foundation, the American Institute Benevolent Fund, Inc., and the Accounting Research Association, Inc. as of July 31, 1975 and 1974 and the related statements of changes in fund balances for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements identified above present fairly the financial position of each of the aforementioned organizations at July 31, 1975 and 1974, and the results of their operations and the changes in their fund balances and, for the American Institute of Certified Public Accountants, the changes in its financial position for the years then ended, all in conformity with generally accepted accounting principles applied on a consistent basis.

Hurdman and Cranstoun

Certified Public Accountants

New York, N.Y.
September 5, 1975

Financial Statements

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Statement of Assets, Liabilities and Fund Balances

	July 31, 1975	July 31, 1974
Assets		
Cash	$ 577,458	$ 414,285
Marketable securities (quoted market: 1975, $5,049,500; 1974, $3,043,900)	5,036,272	3,187,292
Accounts receivable (less allowance for doubtful accounts, $10,000)	1,767,745	1,901,199
Inventories (Note 1)	1,659,305	1,249,585
Deferred authorship costs and prepaid expenses	552,132	551,257
Fixed assets (Note 2)	1,797,024	679,578
	11,389,936	7,983,196
Endowment and other restricted funds:		
Cash	551	1,910
Marketable securities (quoted market: 1975, $603,100; 1974, $565,200)	575,736	600,012
	$11,966,223	$ 8,585,118
Liabilities and Fund Balances		
Liabilities and deferred revenues:		
Accounts payable and other liabilities	$ 1,223,524	$ 1,498,791
Accrued taxes (Note 3)	437,519	348,817
Advance dues	5,439,723	900,140
Unearned publication subscriptions and advertising	1,442,790	1,342,414
	8,543,556	4,090,162
Commitments and contingent liabilities (Notes 4 and 5)		
Fund balances:		
General Fund:		
Appropriated for contingencies	2,000,000	2,000,000
Unappropriated	846,380	1,893,034
Total General Fund	2,846,380	3,893,034
Endowment and other restricted funds	576,287	601,922
	3,422,667	4,494,956
	$11,966,223	$ 8,585,118

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Statement of Revenues and Expenses

	Year Ended July 31, 1975	1974
Revenues:		
Membership dues	$ 5,594,749	$ 5,223,304
CPA examination fees	1,891,270	1,627,748
Publications	4,925,861	4,561,552
Continuing professional education	4,022,743	3,191,381
Government grant for aid to minority business	160,958	88,604
Information retrieval program	230,748	297,442
Investment and sundry income	398,794	460,978
Gain (loss) on sale of securities	(85,070)	37,097
	17,140,053	15,488,106
Expenses (see also summary of expenses by activity):		
Salaries and fees	6,839,113	6,207,734
Personnel costs	1,093,429	961,948
Occupancy	1,913,150	1,199,379
Printing and paper	3,991,609	3,394,769
General	4,309,406	3,546,987
Federal income taxes (Note 3)	40,000	56,600
	18,186,707	15,367,417
Excess (deficiency) of revenues over expenses	($ 1,046,654)	$ 120,689

	1975	1974
Summary of expenses by activity:		
CPA examinations	$ 1,892,919	$ 1,619,443
Publications:		
Cost of sales	4,563,212	4,362,634
Distributed to members and others	1,052,888	983,753
Continuing professional education	4,011,484	2,935,273
Technical:		
Accounting standards	214,578	190,813
Auditing standards	743,143	500,422
Federal taxation	187,570	164,624
Management advisory services	307,486	173,852
Computer services	291,537	163,214
International practice	216,600	202,392
Research	106,774	136,974
Technical information and review	503,313	406,583
Information retrieval	276,453	329,679
Financial Accounting Foundation contribution	207,726	200,000
Commission on auditors' responsibilities	144,307	
Accounting objectives study		72,916
Regulation:		
Ethics and trial board	381,686	285,599
State legislation	189,843	70,655
Relations—members	993,587	852,351
Relations—other groups:		
Public relations	380,997	337,815
State societies	294,229	296,800
Universities	264,158	230,167
Federal government	589,310	541,789
Public assistance programs:		
Government funded aid to minority business	208,431	154,989
Administration of minority student programs	164,476	154,680
	$18,136,707	$15,367,417

Note: With the exception of the Financial Accounting Foundation contribution, each of the above amounts includes a pro rata allocation of administrative expenses, which aggregated $1,700,170 and $1,326,040 for 1975 and 1974, respectively.

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Statement of Changes in Fund Balances

	Year Ended July 31, 1975	1974
General Fund:		
Fund balance, beginning of year	$ 3,893,034	$ 3,772,345
Excess (deficiency) of revenues over expenses	(1,046,654)	120,689
Fund balance, end of year	2,846,380	3,893,034
Endowment and other restricted funds:		
Fund balances, beginning of year	601,922	597,453
Excess (deficiency) of revenues over expenses	428	(1,230)
Gain (loss) on sale of securities	(26,063)	5,699
	(25,635)	4,469
Fund balances, end of year	576,287	601.922
	$ 3,422,667	$ 4,494,956

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Statement of Changes in Financial Position

	Year Ended July 31, 1975	1974
Cash and marketable securities, beginning of year	$ 3,601,577	$ 3,477,636
Sources of funds:		
From operations:		
Excess (deficiency) of revenues over expenses	(1,046,654)	120,689
Add back expenses not requiring outlay of funds—depreciation and amortization of fixed assets and deferred authorship and subscription costs	470,940	392,731
	(575,714)	513,420
Increase (decrease) in liabilities and deferred revenues:		
Accounts payable and other liabilities	(275,267)	659,064
Accrued taxes	88,702	22,817
Advance dues	4,539,583	434,538
Unearned publication subscriptions and advertising	100,376	258,102
	3,877,680	1,887,941
Uses of funds:		
Additions to deferred authorship costs and prepaid expenses	286,700	319,855
Additions to fixed assets	1,302,561	369,490
Increase (decrease) in other assets:		
Receivables	(133,454)	599,789
Inventories	409,720	474,866
	1,865,527	1,764,000
Increase (decrease) in funds:		
Cash	163,173	(69,491)
Marketable securities	1,848,980	193,432
	2,012,153	123,941
Cash and marketable securities, end of year	$ 5,613,730	$ 3,601,577

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS FOUNDATION

Statement of Assets, Liabilities and Fund Balances

	July 31, 1975	July 31, 1974
Assets		
Cash	$ 27,087	$ 3,683
Marketable securities (quoted market: 1975, $443,800; 1974, $420,800)	459,862	460,355
Pledges receivable (less allowance for uncollectible pledges: 1975, $11,615; 1974, $20,550)	146,080	213,708
Other receivables	19,632	11,300
	$ 652,661	$ 689,046
Liabilities and Fund Balances		
Liabilities and deferred credits:		
Accounts payable	$ 5,127	$ 7,166
Grants payable—Accounting Education Fund for Disadvantaged Students		17,663
Contributions designated for future periods	146,080	213,708
	151,207	238,537
Fund balances		
General	10,286	8,390
Library	107,480	108,700
John L. Carey Scholarship Fund	96,132	103,859
Accounting Education Fund for Disadvantaged Students	287,556	229,560
	501,454	450,509
	$ 652,661	$ 689,046

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS FOUNDATION

Statement of Changes in Fund Balances

	Year Ended July 31, 1975	Year Ended July 31, 1974
Additions:		
Investment income	$ 23,227	$ 18,823
Contributions:		
Accounting Education Fund for Disadvantaged Students	198,423	211,114
General	1,594	287
Other		190
	223,244	230,414
Deductions:		
Contributions to American Institute of Certified Public Accountants for:		
Library expenses	5,028	4,728
Accounting research		14,632
Expenditures:		
John L. Carey Scholarship Fund (scholarships)	11,000	7,775
Accounting Education Fund for Disadvantaged Students (grants and scholarships)	151,585	85,577
	167,613	112,712
Increase in funds before loss on sale of securities	55,631	117,702
Loss on sale of securities	(4,686)	(13,111)
Net increase in funds	50,945	104,591
Fund balances, beginning of year	450,509	345,918
Fund balances, end of year	$ 501,454	$ 450,509

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

AMERICAN INSTITUTE BENEVOLENT FUND, INC.

Statement of Assets, Liabilities and Fund Balance

	July 31, 1975	July 31, 1974
Assets		
Cash	$ 19,480	$ 9,981
Marketable securities (quoted market: 1975, $479,700; 1974, $437,600)	475,897	437,968
Notes and mortgages receivable (less allowance for doubtful amounts: 1975, $24,000; 1974, $23,150)	84,060	67,225
Other receivables	5,994	3,236
	$ 585,431	$ 518,410
Liabilities and Fund Balance		
Accounts payable	$ 885	$ 1,871
Fund balance	584,546	516,539
	$ 585,431	$ 518,410

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

AMERICAN INSTITUTE BENEVOLENT FUND, INC.

Statement of Changes in Fund Balance

	Year Ended July 31, 1975	Year Ended July 31, 1974
Additions:		
Contributions	$ 71,220	$ 31,981
Investment income	16,323	16,939
Notes and mortgages received in consideration of benefits paid	18,485	16,625
Other	400	136
	106,428	65,681
Deductions:		
Assistance to members and families	68,621	62,179
Stationery, printing and other expenses	5,504	9,493
	74,125	71,672
Increase (decrease) in fund before gain or loss on sale of securities	32,303	(5,991)
Gain (loss) on sale of securities	35,704	(8,773)
Net increase (decrease) in fund	68,007	(14,764)
Fund balance, beginning of year	516,539	531,303
Fund balance, end of year	$ 584,546	$ 516,539

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements

ACCOUNTING RESEARCH ASSOCIATION, INC.

Statement of Assets, Liabilities and Fund Balance

	July 31, 1975	July 31, 1974
Assets		
Cash	$ 14,996	$ 242,448
Marketable securities (quoted market: 1975, $702,000; 1974, $203,500)	702,000	202,000
Dues receivable	471,562	468,918
Other receivables	4,463	1,593
	$ 1,193,021	$ 914,959
Liabilities and Fund Balance		
Liabilities and deferred credits:		
Due to American Institute of Certified Public Accountants	$ 9,190	
Accounts payable	1,416	$ 3,724
Unearned advance dues	907,869	907,162
	918,475	910,886
Fund balance	274,546	4,073
	$ 1,193,021	$ 914,959

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

ACCOUNTING RESEARCH ASSOCIATION, INC.

Statement of Changes in Fund Balance

	Year Ended July 31, 1975	Year Ended July 31, 1974
Additions:		
Dues	$ 2,178,884	$ 2,098,388
Investment income	50,592	18,509
	2,229,476	2,116,897
Deductions:		
Payments to Financial Accounting Foundation (Note 7)	1,935,701	1,762,433
Accounting Research Program		13,529
Membership promotion	6,566	6,921
Reports to members	11,154	1,833
Stationery, supplies, and other expenses	5,582	3,899
	1,959,003	1,788,615
Net increase in fund	270,473	328,282
Fund balance, beginning of year	4,073	(324,209)
Fund balance, end of year	$ 274,546	$ 4,073

The accompanying summary of significant accounting policies and notes to financial statements are an integral part of these statements.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AND RELATED ORGANIZATION FUNDS

Summary of Significant Accounting Policies

Following is a summary of the significant accounting policies of the American Institute of Certified Public Accountants (Institute) and, where applicable, the American Institute of Certified Public Accountants Foundation (Foundation), American Institute Benevolent Fund, Inc. (Benevolent Fund) and the Accounting Research Association, Inc. (ARA):

- Assets and liabilities, and revenues and expenses, are recognized on the accrual basis of accounting.
- Marketable securities are stated at cost, unless the market value is less than cost and there is evidence the decline in market value is due to other than temporary conditions.
- Inventories are stated at the lower of cost (primarily first-in, first-out) or market.
- Authorship costs applicable to continuing professional education courses and publications, which the Institute expects will be sold in the future, are amortized over a three-year period.
- Fixed assets, consisting of furniture and equipment and leasehold improvements, are stated at cost, less accumulated depreciation and amortization computed on the straight-line method. Furniture and equipment are depreciated over their estimated useful lives of from five to ten years and leasehold improvements are amortized over the shorter of the useful lives of the improvements or the lease period.
- Dues are recorded by the Institute as revenues in the applicable membership period. ARA dues, which are assessed to members on a calendar year basis, are recorded as additions to fund balance proratably over each calendar year; however, payments are made to the Financial Accounting Foundation and charged to fund balance generally as dues are collected.
- Subscription and advertising revenues are reflected as revenues when publications are issued.
- Contributions to specific funds are reflected as additions to fund balances in the applicable support period; pledges received by the Foundation in support of future periods are recorded, and allowances for estimated uncollectible pledges are provided.
- Notes and mortgages received by the Benevolent Fund in consideration for assistance payments to members and their families are recorded as additions to fund balance in the period received, net of amounts deemed uncollectible.
- The Institute has a retirement plan covering all eligible employees. Pension expense is accrued in accordance with an actuarial cost method and although the plan may be terminated by the Institute at any time, it is the Institute's policy to fund pension cost accrued. Prior service costs under the plan are being funded over a 30-year period from May 1, 1968.

Notes to Financial Statements
July 31, 1975 and 1974

1. Inventories

Inventories of the Institute at July 31, 1975 and 1974 consisted of:

	1975	1974
Paper and material stock	$ 304,590	$ 198,292
Publications in process	245,694	250,448
Printed publications and continuing professional education course material	1,109,021	800,845
	$1,659,305	$1,249,585

2. Fixed assets

Fixed assets of the Institute at July 31, 1975 and 1974 consisted of:

	1975	1974
Furniture and equipment..........	$1,338,720	$ 682,303
Leasehold improvements.......	905,408	691,383
	2,244,128	1,373,686
Less accumulated depreciation and amortization	447,104	694,108
	$1,797,024	$ 679,578

Depreciation and amortization charged to operations for the years ended July 31, 1975 and 1974 amounted to $185,116 and $212,783, respectively.

3. Taxes

The Internal Revenue Service is currently examining the Institute's Federal payroll tax returns covering the calendar years 1969 through 1974. It questions the Institute's position that graders of CPA examinations are independent contractors. If graders are determined to be employees, fees paid to them are subject to Federal, state and local employment taxes. In 1974, the Institute paid an assessment of Federal income taxes and interest totaling $77,600 on its net advertising income for the years ended August 31, 1969 and 1970. Provision has been made in the financial statements for payroll taxes that may be assessed and for income taxes.

4. Lease commitments

Rentals under noncancelable leases in effect as of July 31, 1975 aggregated approximately $26,263,000 including $304,000 for computer equipment. This amount is exclusive of any future escalation charges for real estate taxes and building operating expenses or any reduction in the event of lease of unoccupied office space (resulting from the move of the Institute headquarters office) prior to April 30, 1978. The lease for the new quarters can be terminated at the end of fifteen years if certain penalties are paid. The minimum rental commitments are summarized below:

Years Ended July 31,	
1976	$ 1,593,000
1977	1,593,000
1978	1,573,000
1979	1,395,000
1980	1,357,000
1981-1985	6,627,000
1986-1990	6,554,000
1991-1995	5,571,000
	$26,263,000

Rental expense for the years ended July 31, 1975 and 1974 was approximately $1,542,000 and $876,000, respectively.

5. Retirement plan

Pension expense relating to the Institute's retirement plan amounted to approximately $390,000 and $343,000 for the years ended July 31, 1975 and 1974, respectively. The currently estimated amount required to complete the funding of prior service costs (over a remaining period of 23 years) under the plan is $214,000.

Changes will be made in 1976 to bring the plan into compliance with the provisions of the Employee Retirement Income Security Act of 1974, and pension expense is expected to increase as a result. It is not possible at this time to estimate the amount of increase, although such amount is not expected to be material.

6. Commitment of Foundation funds

The American Institute of Certified Public Accountants Foundation plans to distribute over the next three years a total of approximately $245,000 among eight universities to support scholarship grants to minority students.

7. Commitment to Financ al Accounting Foundation (FAF)

In October 1972, the Accounting Research Association, Inc. (described in Note 8) stated its intent to use its best efforts to raise sufficient funds from sources within the accounting profession to ensure that the FAF receives in each of the five years commencing January 1, 1973 at least $2,000,000 from these sources. Including contributions from all sources within the accounting profession, this commitment was met for calendar years 1973 through 1975.

8. Special purpose and related organization funds

The purposes of the special and related organization funds are as follows:

Endowment Fund
To maintain a reference library and reading rooms for members of the Institute. Investment income from marketable securities held by the Endowment Fund is included as revenues in the General Fund in accordance with provisions of the endowment.

Foundation
To advance the profession of accountancy, and to develop and improve accountancy education.

Benevolent Fund
To solicit, collect and otherwise raise money in order to provide financial assistance to needy members of the Institute and their families.

Accounting Research Association, Inc.
To encourage research in accounting, auditing and related areas of CPA practice through a best efforts commitment to provide financing for the Financial Accounting Foundation.

Index of Presentations by AICPA from January, 1975 through March, 1976

DATE	DIVISION	AGENCY	TITLE
1/14/75	Accounting Standards	Public	Memorandum on "Applying Investment Companies Audit Guide to SEC Filings" (Investment Companies T.F.)
1/17/75	Accounting Standards	FASB	SOP 75-1, "Revenue Recognition When Right of Return Exists"
1/28/75	Auditing Standards	SEC	L/C on proposed revisions to HIM-15 Sections 2336.2-3 Section 2337-2337.4
2/3/75	Accounting Standards	SEC	Letter on valuation methods for money market funds
2/7/75	Auditing Standards	SEC	FOCUS Report revised Discussion Paper of December 16, 1974
2/14/75	Accounting Standards	SEC	Letter on quotation of yield rates by money market funds
2/17/75	Accounting Standards	CASB	L/C on staff draft standard, "Accounting for Acquisition Cost of Material"
2/18/75	Auditing Standards	SEC	L/C on HIM-15, Chapter 6
2/24/75	Accounting Standards	Public	Exposure draft, "Presentation and Disclosure of Financial Forecasts"
2/27/75	Accounting Standards	CASB	L/C on questionnaire, "Composition, Measurement and Allocability of Deferred Compensation Cost"
2/28/75	Federal Taxation	IRS	Comments on Proposed Regulations Under Section 103(c) (4)(F) Regarding Industrial Development Bonds
2/28/75	Federal Taxation	Senate Select Com. on Small Business	Tax Problems of Small Business
3/6/75	Accounting Standards	Internal	Letter expressing views on reporting practices for cash and cash equivalents
3/7/75	Accounting Standards	FASB	L/C on exposure draft, "Reporting Gains and Losses From Extinguishments of Debt"
3/13/75	Institute	SEC	Comments on Proposed Amendments to Rule 4-02 (File No. S7-540)
3/20/75	Auditing Standards	SEC	L/C on HIM-15, Chapter 22
3/24/75	Institute	FCC	Proposed Rulemaking relating to the substitution of Equal Life Group

Index of Presentations by AICPA from January, 1975 through March, 1976--Continued

DATE	DIVISION	AGENCY	TITLE
3/25/75	Institute	IRS	Proposed Proedural Rules under Part 601, Relating to Public Inspection of Certain Rulings and Determination Letters
3/31/75	Accounting Standards	Public	Discussion Paper on "The Application of GAAP to Smaller and/or Closely-Held Businesses"
3/31/75	Federal Taxation	IRS	Comments on Proposed regulations under Sections 902 and 904 Regarding Separate Limitations on Foreign Tax Credit in Case of Dividends from a DISC or Former DISC
4/11/75	Auditing Standards	SEC	L/C on Securities Act Release No. 33-5549, Commission's Notice of Proposals to Increase Disclosure of Interim Results by Registrants (File No. S7-542)
4/11/75	Auditing Standards	SEC	L/C on Revision of Section 2312.1 HIM-15
4/11/75	Auditing Standards	SEC	L/C on Revision of Chapter 22, HIM-15
4/28/75	Accounting Standards	FASB	L/C on exposure draft, "Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements"
4/29/75	Accounting Standards	Cong. Subcoms.	Statement on Cost Accounting Standard No. 409 (House and Senate public hearings)
4/8/75	Federal Taxation	IRS	Proposed Regulations Under Sections 406 and 407 Regarding Foreign Subsidiaries or Domestic Subsidiaries engaged in Business Outside the United States
4/29/75	Accounting Standards	Senate Banking Subcom. on Production & Stabilization/House Banking Subcom. on Economic Stabilization	Cost Accounting Standard No. 409
5/5/75	Accounting Standards	FASB	Supplementary comments (rec'd from Investment Companies T.F.) on exposure draft on foreign currency
5/8/75	Accounting Standards	SEC	SEC Release No. 33-5569, Disclosure with respect to compliance with environmental requirements and other matters
5/20/75	Accounting Standards	CASB	Letter to staff on accounting for costs of service centers

Index of Presentations by AICPA from January, 1975 through March, 1976--Continued

DATE	DIVISION	AGENCY	TITLE
5/27/75	Institute	Comptroller of the Currency, Federal Reserve Board Federal Deposit Insurance Corp.	Proposed Rules of the Bank Regulatory Agencies
5/29/75	Accounting Standards	DOL	"Comments for the Department of Labor Regarding Reporting and Disclosure Under the Employee Retirement Income Security Act of 1974"
6/5/75	Accounting Standards	FASB	L/C on exposure draft, "Accounting for Income Taxes -- Oil and Gas Producing Companies"
6/6/75	Federal Taxation	IRS	Tax Policy Concerning the Taxation of Capital Gains
6/6/75	Government Relations	Civil Service Comm.	Proposed Qualification Standard for Accounting Series, GS-510 "Basic Requirements for all Grades"
6/10/75	Auditing Standards	SEC	L/C on Section 1010-HIM-15
6/12/75	Accounting Standards	FASB	Letter on Emerging Practice Problems -- Marketable Securities
6/12/75	Accounting Standards	CASB	Letter on "Definitions of Various Terms"
6/12/75	Federal Tax	IRS	Comments on Technical Information Release 1365 (4/17/75) (Also published as Announcement 75-42, 1975-19 IRB 138 (5/12/75) Regarding the Full Absorption Method of Inventory Costing
6/13/75	Institute	House Subcom. on Transportation and Commerce	Letter on Uniform System of Accounts for Railroads
6/19/75	Federal Tax	IRS	Comments on Proposed Regulations Under Section 2001 of the Employee Retirement Income Security Act of 1974 (I.R.C. Secs. 401, 404) Regarding Contributions to Pension, Profit-Sharing, Etc. Plans on Behalf of Self-Employed Individuals
6/23/75	Auditing Standards	SEC	L/C on Securities Act Release No. 33-5579 Securities Act Release No. 34-11354

Index of Presentations by AICPA from January, 1975 through March, 1976--Continued

DATE	DIVISION	AGENCY	TITLE
6/23/75	Federal Government	Senate Finance, Subcom. on Health/House Interstate & Foreign Commerce, Subcom. on Health & Environment/ House Ways & Means, Subcom. on Health	Position Paper on National Health Insurance
6/25/75	Accounting Standards	SEC	Letter on Release No. 8757, Investment Company Act of 1940
6/25/75	Government Relations	Rep. Roy	L/C on Audit provision contained in HR 14409
6/27/75	Accounting Standards	FASB	SOP 75-2, "Accounting Practices of Real Estate Investment Trusts"
6/27/75	Government Relations	Rep. Jack Brooks	Letter on "CPA" HR 7575
7/2/75	Institute	Small Business Admin.	L/C on Proposed Rulemaking - Small Business Administration dollar size standards revision (13 CFR 121)
7/2/75	Institute	Labor Management Service Admin.	L/C on Proposed Rulemaking - Employee Retirement Income Security Act of 1974
7/3/75	Accounting Standards	CASB	L/C on proposed standard, "Composition and Measurement of Pension Cost"
7/3/75	Accounting Standard	FASB	Letter urging acceleration of FASB work on pension costs
7/3/75	Federal Taxation	IRS	Comments on Proposed Regulations Under Section 402 Regarding Lump Sum Distributions
7/9/75	Government Relations	Rep. Heinz	Letter on HR 7014
7/10/75	Federal Government	DOL	Letter on Employee Retirement Income Security Act of 1974
7/11/75	Accounting Standards	CASB	Letter on preliminary draft issues paper, "Accounting for Costs of Service Centers"
7/11/75	Institute	FCC	L/C on Proposed Rulemaking (Docket No. 20489)
7/14/75	Accounting Standards	CASB	Letter on May 1975 issues paper, "Cost of Money as Part of Cost of Capital"

Index of Presentations by AICPA from January, 1975 through March, 1976--Continued

DATE	DIVISION	AGENCY	TITLE
7/14/75	Federal Taxation	IRS	Recommendations for Revision of Form 1040 and Other Tax Forms
7/15/75	Federal Government	Chairman, Senate Subcom. on Anti-trust and Monopoly	Letter on S.1284 - Antitrust Improvements Act of 1975
7/22/75	Auditing Standards	SEC	L/C on Proposed revision to HIM-15, Section 2160.2
7/22/75	Accounting Standards	CASB	Letter on Questionnaire/Issues Paper on "Composition, Measurement and Allocability of Deferred Compensation Costs"
7/30/75	Auditing Standards	SEC	L/C on Report Coordinating Group, First Annual Report to the SEC, 6/16/75 regarding the FOCUS Report
7/30/75	Institute	SEC	Release No. 33-5581, concerning the Integration of Financial Forecasts into the Disclosure System
7/31/75	Accounting Standards	SEC	Letter on "Proposal to Standardize Money Market Fund Yield Quotations," (File No. S7-568)
7/25/75	Accounting Standards	FASB	Letter on Emerging Practice Problem — Accounting for Restructured Debt
7/31/75	Accounting Standards	FASB	Letter on Emerging Practice Problem -- Interim Financial Reporting (APB 28 Implementation Problems)
7/31/75	Institute	SEC	L/C on Release No. 33-5587 -- Commission's proposal to amend those sections of Reg. S-X
8/6/75	Accounting Standards	FASB	Letter on Emerging Practice Problem -- Preferred Stock Classification
8/6/75	Accounting Standards	FASB	Letter on Emerging Practice Problem -- Accounting for Restricted Stock Purchase Plans
9/3/75	Institute	SEC	Letter on Form 8-K, Item 10(a)
9/4/75	Institute	Rep. Moss	Letter on Title VIII of HR 7014
9/10/75	Government Relations	Congress	Cover letter and copy of Recommended Tax Law Changes

Index of Presentations by AICPA from January, 1975 through March, 1976--Continued

DATE	DIVISION	AGENCY	TITLE
9/11/75	Auditing Standards	SEC	L/C on Proposal to adopt the FOCUS Report and Proposal to Amend Rules 17a-3, 17a-4, 17a-5 and Form X-17A-5 and Form X-17A-11 Under the Securities and Exchange Act of 1934
9/12/75	Federal Taxation	Finance and Ways & Means committees	Letter on Recommended Tax Law Changes
9/15/75	Federal Taxation	Staffs of: Joint Com., Ways & Means, Senate Finance Com.	Letter on Recommended Tax Law Changes
9/26/75	Accounting Standards	FASB	SOP 75-3, "Accrual of Revenue and Expenditures by State and Local Governmental Units"
9/26/75	Accounting Standards	FASB	L/C on exposure draft, "Financial Reporting in Units of General Purchasing Power"
9/26/75	Accounting Standards		SOP 75-4, "Presentation and Disclosure of Financial Forecasts"
10/3/75	Accounting Standards	FASB	L/C on exposure draft, "Extension of 'Grandfather' Provisions of APB Opinion No. 16"
10/9/75	Accounting Standards	FASB	L/C on Emerging Practice Problem -- LIFO Implementation Problems"
10/17/75	Accounting Standards	FASB	Letter on Emerging Practice Problem -- Business Combinations of Savings and Loan Associations
10/31/75	Accounting Standards	FASB	L/C on exposure draft, "Accounting for Leases"
11/3/75	Accounting Standards	DL/IRS	L/C on "Pension and Welfare Plans -- Annual Information Returns/Reports"
11/13/76	Federal Taxation	Select Com. on Small Business	Tax Problems of Small Business
11/14/76	Accounting Standards	CASB	L/C on proposed standard, "Allocation of Business Unit G&A Expenses to Final Cost Objectives"
11/19/76	Federal Taxation	IRS	Comments on Discussion Draft of Proposed Regulations Under Sec. 61
12/5/75	Accounting Standards	FASB	L/C on exposure draft, "Accounting for Certain Marketable Securities"

Index of Presentations by AICPA from January, 1975 through March, 1976--Continued

DATE	DIVISION	AGENCY	TITLE
12/8/75	Accounting Standards	FASB	L/C on exposure draft, "Accounting for Contingencies -- Transition Method"
12/11/75	Accounting Standards	FASB	L/C on exposure draft, "Restructuring of Debt in a Troubled Loan Situation"
12/29/75	Accounting Standards	FASB	SOP 75-5, "Accounting Practices in the Broadcasting Industry"
12/29/75	Accounting Standards	FASB	SOP 75-6, "Questions Concerning Profit Recognition on Sales of Real Estate"
1/15/76	Federal Taxation	IRS	Comments on Proposed Regulations Under Sections 613 and 613A Regarding Percentage Depletion in the Case of Oil and Gas Wells
1/14/76	Accounting Standards	CASB	L/C on Casb Staff Issues Paper, "Distinguishing Between Direct and Indirect Costs"
1/21/76	Federal Taxation	IRS	Comments on Proposed Regulations Under Section 414(b) and (c) Regarding Employees of Organizations Under Common Control
1/23/76	Federal Taxation	IRS	Comments on Proposed Regulations Under Sections 664 and 2055 Regarding Transfers for Public, Charitable and Religious Uses
1/29/76	Accounting Standards	Select Com. on Small Business	Letter to Committee re ERISA
1/30/76	Accounting Standards	SEC	Proposed amendments to Require Disclosure of Certain Replacement Cost Data
2/2/76	Accounting Standards	CASB	L/C on CASB draft standard, "Cost of Money as an Element of the Cost of Capital"
2/3/76	Federal Government	Div. of Provider Reimbursement & Accounting Policy, Bureau of Health Insurance	Proposed Revision to Provider Reimbursement Manual -- Section 215/Costs Associated with the Recall of Bonds Before Maturity
2/11/76	Federal Government	OMB	Proposed Rulemaking -- Jointly funded assistance to state and local governments and private, nonprofit organizations (34 CFR Part 259)

Index of Presentations by AICPA from January, 1975 through March, 1976--Continued

DATE	DIVISION	AGENCY	TITLE
2/16/76	Accounting Standards	CASB	L/C on draft standard, "Accounting for Deferred Compensation Cost
3/8/76	Accounting Standards	FASB	Letter on Subjective Acceleration clauses in Long-Term Debt Agreements
3/8/76	Federal Government	Social Rehabilitation Service, HEW	L/C on proposed addition of Part 283 to Chapter II of Title 45 of the Code of Federal Regulations
3/9/76	Federal Government	Food & Nutrition Service, Dept. of Agriculture	L/C on proposed rulemaking to redesignate and amend the Department' regulations governing the Nonfood Assistance Program
3/15/76	Federal Tax	House Ways & Means	Statement on Estate and Gift Tax reform
3/5/76	Federal Tax	Privacy Protection Study Commission	Statement on Federal Tax Return Confidentiality
3/18/76	Federal Tax	Senate Finance Com.	Statement on Tax Revision (HR 10612)
3/25/76	Accounting Standards	SEC	L/C on Disclosure of details of marketable and other investment securities (File No. S7-610)
3/31/76	Federal Government	All Federal Grant Agencies	GAO Recommendations for Audits

(Excerpted from AICPA Committee Handbook)

FEDERAL TAXATION EXECUTIVE COMMITTEE

Objective: To supervise, coordinate, plan and initiate all of the projects, programs and activities including budget appropriations of the twelve constituent Committees which comprise the Tax Division.

EMPLOYEE BENEFITS SUBCOMMITTEE

Objective: To formulate and submit to Congress, the Treasury Department and Internal Revenue Service technical and policy recommendations for improvement of the federal tax process relating to employee benefit plans and deferred compensation for employees and self-employed individuals.

FINANCIAL AND ESTATE PLANNING SUBCOMMITTEE

Objective: To formulate and submit to Congress, the Treasury Department and Internal Revenue Service technical and policy recommendations for improvement of the federal tax process relating to the taxation of estates, trusts, beneficiaries and decedents and to estate and gift taxes. To encourage CPAs to be well prepared to participate in financial and estate planning work; to encourage state societies to adopt financial and estate planning programs; to develop a recommended approach and "how-to-do-it" guidelines for the CPA in financial and estate planning; to disseminate and encourage an interchange of financial and estate planning techniques among CPAs; and to encourage CPAs to participate in estate planning councils.

INTERNATIONAL TAXATION SUBCOMMITTEE

Objective: To formulate and submit to Congress, the Treasury Department and Internal Revenue Service technical and policy recommendations for improvement of the federal tax process relating to the tax based on income from sources within or without the U.S. and the interest equalization tax.

RESPONSIBILITIES IN TAX PRACTICE SUBCOMMITTEE

Objective: To identify and develop appropriate standards of responsibilities in tax practice and to promote their uniform application by CPAs; to encourage the development of increased understanding of the responsibilities of the CPA by the Treasury Department and the Internal Revenue Service and to urge their officials to promote the application of commensurate standards of responsibility by their personnel; and to foster increased public compliance with and confidence in our tax system through awareness of the standards of conduct accepted by CPAs and of reciprocal measures adopted by the Treasury Department and the Internal Revenue Service.

SCOPE AND MANAGEMENT OF A TAX PRACTICE SUBCOMMITTEE

Objective: To advise the Division's Executive Committee and the Institute concerning the nature and scope of the CPA's tax practice. To consider what the CPA feels his role ought to be and to help him achieve these goals. Particular emphasis will be placed on subjects such as privileged communication, the effects of computer technology, encroachment, practice administration, basic tax education and professional development.

TAX ACCOUNTING SUBCOMMITTEE

Objective: To formulate and submit to Congress, the Treasury Department and Internal Revenue Service technical and policy recommendations for improvements of the federal tax process relating to accounting periods and methods of accounting.

TAX ADMINISTRATION SUBCOMMITTEE

Objective: To formulate and submit to Congress, the Treasury Department and Internal Revenue Service technical and policy recommendations for improvement of the federal tax process relating to procedural and general administrative matters.

TAX DETERMINATION SUBCOMMITTEE

Objective: To formulate and submit to Congress, the Treasury Department and Internal Revenue Service technical and policy recommendations for improvement of the federal tax process relating to the determination of tax liability including computation of taxable income, determination of gain or loss on disposition of property, capital gains and losses, readjustment of tax between years and consolidated returns.

TAX FORMS SUBCOMMITTEE

Objective: To review all Federal Tax Forms and submit to the Internal Revenue Service recommendations for simplification and revision where required. This is accomplished in part through participation with state society tax committees in an annual tax forms review project. In addition, the committee reviews Treasury publications such as the "Tax Guide for Small Business" and makes recommendations for improvements to the appropriate parties.

TAX PUBLICATIONS SUBCOMMITTEE

Objective: To assist in the development and preparation of informative documents designed to aid Institute members to maintain and improve their technical proficiency.

TAX POLICY SUBCOMMITTEE

Objective: To identify subject areas and supervise and coordinate the preparation of well-researched position papers on matters of tax policy.

TAXATION OF CORPORATE DISTRIBUTIONS AND ADJUSTMENTS SUBCOMMITTEE

Objective: To formulate and submit to Congress, the Treasury Department and Internal Revenue Service technical and policy recommendations for improvement of the federal tax process relating to corporate distributions and adjustments, corporations used to avoid income tax on shareholders and the tax on transfers to avoid income tax.

TAXATION OF SPECIAL ENTITIES AND INDUSTRIES SUBCOMMITTEE

Objective: To formulate and submit to Congress, the Treasury Department and Internal Revenue Service technical and policy recommendations for improvement of the federal tax process relating to deferred compensation, exempt organizations, banking institutions, natural resources, partners and partnerships, insurance companies, regulated investment companies, real estate investment trusts, subchapter S corporations, tax on self-employment income and withholding taxes.

(Excerpted from AICPA Committee Handbook)

ACCOUNTANTS' LEGAL LIABILITY COMMITTEE

Objective: To obtain reliable information as to claims against accountants; to review the legal responsibilities of independent accountants under the various SEC statutes; to disseminate educational material on the subject of accountants' legal liability to the Institute membership; to assist members against whom legal action is being threatened; and to maintain current information on the status of indemnity insurance programs.

RELATIONS WITH ACTUARIES COMMITTEE

Objective: To develop and maintain cooperative relations between CPAs and actuaries, to explore areas of concern to both groups and to advise the senior technical committees and the membership of the Institute of developments in such matters.

STATE AND LOCAL GOVERNMENT AUDITING SUBCOMMITTEE

Objective: To review current developments in the administration of municipal governments, to appraise governmental accounting practices, to consult with municipal government associations on accounting and auditing matters, and to advise the senior technical committees and the membership of the Institute on the auditing of municipal governments.

STATISTICAL SAMPLING SUBCOMMITTEE

Objective: To disseminate information about the application of statistical sampling to accounting and auditing, including advising and assisting in the publication of an Institute book on statistical sampling and auditing, to maintain cooperative relations with statisticians, and to advise the senior technical committees and the membership of the Institute on matters relating to statistical sampling.

STOCKBROKERAGE AUDITING SUBCOMMITTEE

Objective: To maintain communications between regulatory agencies, the brokerage industry and the accounting profession; to promote the use of GAAP and adoption of sound reporting practices in the brokerage industry.

BOARD OF DIRECTORS

Objective: To advance the Institute's continuing objectives through distinguished leadership and effective management.

PLANNING AND FINANCE COMMITTEE

Objective: To maintain the relevance of the Institute's continuing objectives and contribute to their advancement by reviewing strategy, plans, budgets —including the compensation of staff officers and ranges of compensation for exempt staff—and material deviations in plans and budgets prior to discussion by the Board of Directors.

COMPUTER SERVICES EXECUTIVE COMMITTEE

Objective: To study and report on the implications of electronic data processing for the accounting profession and to supervise the activities of its constituent subcommittees.

EDITORIAL ADVISORY COMMITTEE— *JOURNAL OF ACCOUNTANCY*

Objective: To assist the editors of the *Journal of Accountancy* in selecting material of high quality for publication, to suggest subjects which need to be covered, and to recommend improvements in the magazine.

EDITORIAL ADVISORY COMMITTEE— *THE TAX ADVISER*

Objective: To assist the editors of *The Tax Adviser* in selecting material of high quality for publication, to suggest subjects which need to be covered in future issues, and to suggest improvements in the magazine.

INFORMATION RETRIEVAL COMMITTEE

Objective: To supervise the operation and related activities of the National Automated Accounting Retrieval System (NAARS).

INTERNATIONAL PRACTICE EXECUTIVE COMMITTEE

Objective: To promote the exchange of information among accountants throughout the world, to encourage freedom of movement of accountants and auditors across national boundaries, and to foster a better understanding of the international aspects of public accounting among AICPA members.

PRACTICE REVIEW COMMITTEE

Objective: To reduce deviations from acceptable reporting practice through education of practitioners as to the application of GAAP and practices in specific cases, and to encourage state societies in developing programs to deal with the problems at the local level in cooperation with bankers and other credit grantors.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

666 FIFTH AVENUE
NEW YORK, N. Y. 10019

April 12, 1972

To Members of Council
of the American Institute of
Certified Public Accountants

I am enclosing a copy of a policy statement on the report of the study group on the establishment of accounting principles which was approved today by the Board of Directors at the close of a special two-day meeting.

The report and this recommendation will be on the agenda of the spring meeting of Council in Boca Raton. The discussion will open with a presentation by Francis Wheat, chairman of the study group.

Favorable action on the Board's recommendation would require a modification in Rule 203 on accounting principles in the proposed restatement of the Institute's Code of Professional Ethics which is also on the agenda of the Council's spring meeting. The precise language to accomplish such a change will be sent to you within the next few days by the AICPA's Ethics Division.

Sincerely yours,

John Lawler

JL:s
enclosure

John Lawler
Administrative Vice President

cc: State Society
Executive Directors
AICPA Committee Chairmen

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Statement by the Board of Directors of the AICPA on the Wheat Report on Accounting Principles

At a special meeting held on April 10-11 in New York City, the Board of Directors of the American Institute of Certified Public Accountants has resolved to urge the AICPA's Council -- the organization's top-policy body -- to adopt a report submitted on March 29, 1972 by the study group on the establishment of accounting principles.

The year-long study, conducted by a seven-man group headed by Francis M. Wheat, former member of the Securities and Exchange Commission, recommended among other things that the present Accounting Principles Board composed of volunteers drawn from the AICPA membership be replaced by a full-time paid Financial Accounting Standards Board, operating under a Foundation organized by, but functioning separately from, the AICPA.

All members of the study group were present at the first day of the special meeting to aid the Institute's Board of Directors in its deliberations.

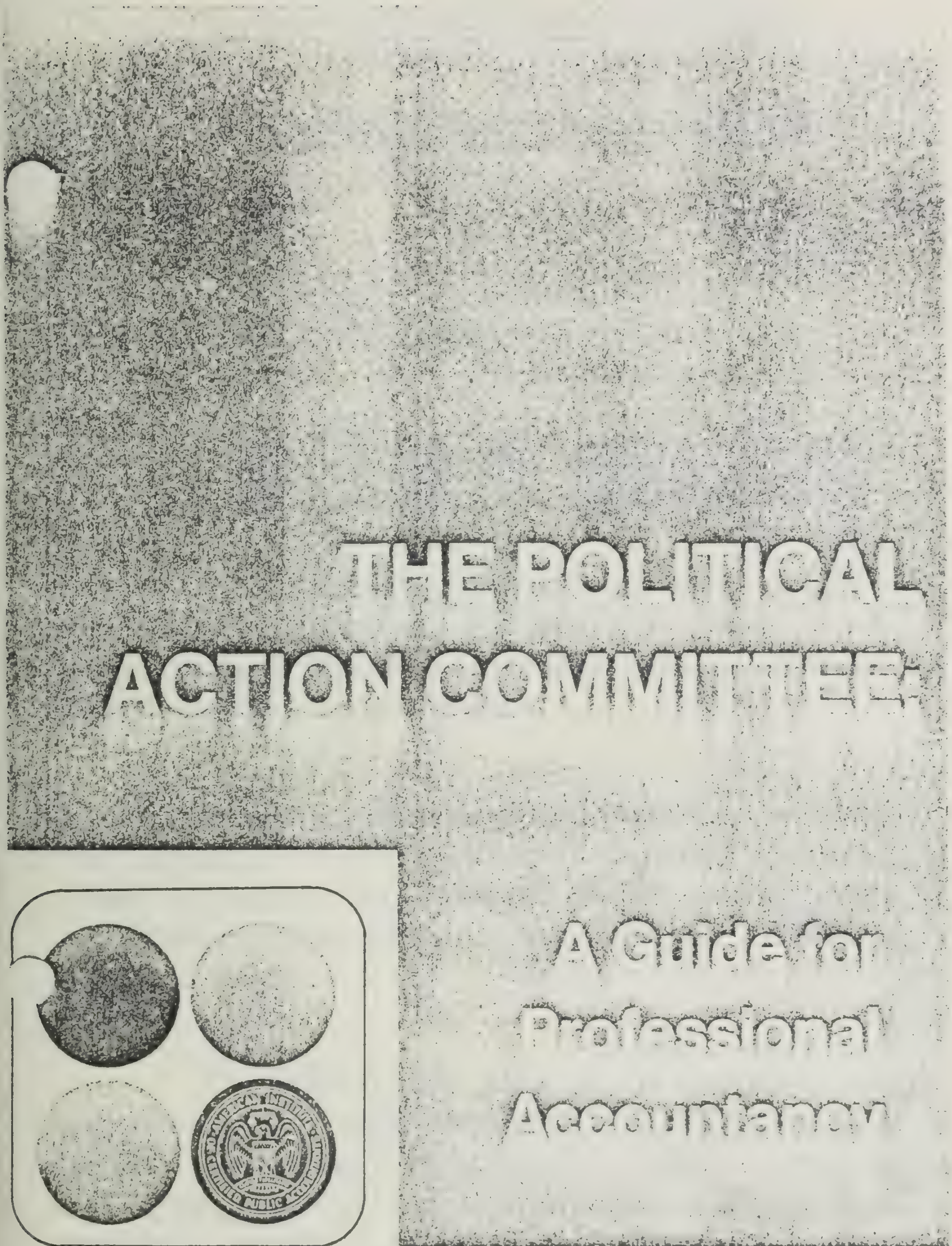
The Board recognized that prompt action to implement the recommendations would be highly desirable in the public interest to avoid any extended interruption in the effort to improve standards of financial reporting.

In deciding to seek final approval of the report by the AICPA Council on May 1-3, the Board also took cognizance of the fact that a number of important organizations within the financial community have already voiced approval of the study group's principal recommendations.

Between now and May 1 the Board expects to receive additional comments on the report from a number of interested organizations and individuals within and without the profession.

In order to facilitate timely and appropriate consideration of the report, the Board of Directors requested the president of the Institute to create a special committee with a three-part mission: to continue to canvas reactions to the report, to determine the extent of the financial support which can be reasonably expected to finance the expanded program envisioned in the report, and to develop proposals for the initial steps which must be taken to carry out its major recommendations.

In strongly urging the AICPA Council to adopt the report and to authorize its prompt implementation, the Board concurred in the judgment of the study group that an urgent need exists for "a bold new effort to insure public confidence in the ways in which financial information is reported." It is also convinced that the approach outlined in the report constitutes just such an effort -- with considerable promise of achieving the goal of preserving public confidence in the integrity of financial reporting.



American Institute of Certified Public Accountants
1211 Ave. of The Americas, New York, New York 10036

Committee on State Legislation
American Institute of Certified Public Accountants

THE POLITICAL ACTION COMMITTEE:

A GUIDE FOR PROFESSIONAL ACCOUNTANCY

Why Contribute to Campaigns?

Giving money to assist political campaigns is both a civic responsibility and a political opportunity.

It is a responsibility because most campaign dollars are used to present a candidate's message and to develop support for him. Thereby, dollars stimulate interest in the election process.

Despite controls and criticism, it is not likely that campaign costs will diminish. Improved communications techniques, new uses of media and a growing population will continue to increase the cost of running for public office.

The republic is in deep trouble if only the rich can afford to campaign. To have a choice between well-qualified candidates, citizens must be willing to pay the cost of campaigning. And even seemingly high campaign costs are a bargain, for nothing can be more important to the citizen than the quality of his government.

Giving to a campaign fund is a political opportunity because it thanks an incumbent whose actions have reflected the donor's views and helps a first-time candidate who seems likely to work for the contributor's beliefs.

Campaign contributions do not "buy" anything from the vast majority of elected officials. All the contributor should expect is the candidate's awareness of his help, an adequate hearing of his views and thoughtful consideration of them. The contributor is entitled to access to the candidate but not to an automatic commitment of help from him. If the contributor judged the candidate's philosophy correctly when he gave his help and if his legislative cause is just, in most instances access is all that is needed.

The Advantages of Political Action Committees

Few citizens can make contributions to enough candidates, in amounts which provide important help, to thank, support and assure a sympathetic hearing from enough elected officials to affect a legislative program or to promote a political cause strongly.

But twenty-five dollars from each of two hundred citizens provides five thousand dollars. This is enough to make a significant impact on ten campaigns for the state legislature, or to provide noticeable aid in twenty-five such campaigns. Clearly, the first reason for having a political action committee is to gain maximum advantage from a combination of relatively small contributions.

A companion reason is clear identification to the candidate of some interest which the donors have in common. If a number of donors in a single profession band together to thank him or to help him for the first time, he becomes very aware of their action. He knows or can assume the reason for it. If he disagrees with them or fears them, he may return the contribution—and this happens more frequently than one might think. But if he shares their interest or agrees with it, he accepts the combined contribution made through their political action committee and remembers the identification of these donors' common interest.

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Political Action Committees for the Profession

Organized labor pioneered the evolution of the political action committee. A few years later, various business and industry groups saw that this structure and method made sense and set up their own PACs. And more recently, some of the professions have followed suit.

State and federal election laws are varied and complicated. Labor, business and professions have experimented with different approaches to organizing PACs and varying styles of operating them.

The Association Department of the United States Chamber of Commerce has performed an invaluable service by publishing a definitive book, "Business and Professional Political Action Committees," by George D. Webster. This book's emphasis is on *federal* laws, procedures and elections. While professional accountancy's political interest is mainly at the *state* level, the book is relevant because the state level PAC resembles that organized for federal campaigns. The Webster book should be the basic reference for a state level group even though state laws are less complex and stringent and a simpler structure is possible.*

AMPAC, the American Medical Political Action Committee, is a complete model for professionals who desire to organize a PAC. Political necessity spurred the medical profession to develop an efficient, effective

structure which functions at all levels of government. For more limited state purposes, the AMPAC program may be adapted and modified easily. AMPAC is described thoroughly, with examples of its materials, in "Business and Professional Political Action Committees."

Mr. Webster's book answers the main questions about legal structure, methods of solicitation and operations of the PAC. It gives check lists of do's and don'ts, sample documents and materials and valuable exhibits and appendices. By studying this book and the model provided by AMPAC, certified public accountants who are contemplating setting up a PAC will be spared months of research and uncertainty. The book is available from:

Association Department
Chamber of Commerce of the United States
1615 H Street, N.W.
Washington, D.C. 20006.

Price list:	1 - 9 copies	$3.50 each
	10 - 99 copies	$2.80 each
	100 plus copies	$2.45 each

*Since publication of this book, the Federal Election Campaign Act of 1971 was passed by Congress and signed into law by the President. The new law affects only campaigns for the federal Congress and the Presidency; it changes the reporting system for political action committees which contribute to these campaigns. The Webster book still has great value in showing how to organize a PAC, but officers of any Committee which plans to give to federal campaigns should study the new Act as well.

How to Begin

The general rule for a PAC is that legally and for tax purposes it must be separate from the professional organization whose members organize it, but it is politically advantageous to identify it with the profession. The degree of its separateness will vary from state to state and according to its purpose. When initiating a political action committee:

1. Organize a nucleus group of colleagues who share a desire to establish a PAC.

2. Study carefully "Business and Professional Political Action Committees" by George D. Webster, including the federal sections. You may want your PAC to work in federal campaigns some day; it is easier to organize it correctly from the outset.*

3. Consult legal counsel at once. It is essential to have sound legal guidance from the beginning.

4. Review the project with a cooperative state election official. Much benefit can be gained from his experience with other groups. (In organizing a PAC you are doing nothing incorrect or questionable. Quite the contrary: if more common-interest groups would do so, the entire political process would benefit.)

5. Seek the advice of physician-leaders in your state's medical political action committee. You will find their experience helpful.

*Remember to also review the Federal Election Campaign Act of 1971 which gives the most up-to-date information on federal reporting requirements for committees.

About Contributions

1. Contributions made early in the campaign are doubly welcome.

2. Relatively small contributions are far better than nothing.

3. Contributions should be made in person by a PAC member who is a constituent or friend of the recipient.

4. If possible, it is wise to make a second contribution late in the campaign, during its inevitable last-minute financial emergency; you may wish to reserve funds accordingly.

A Final Word

Far from being a surreptitious or quasi-secret activity, an effective Political Action Committee should be a source of pride.

It makes democracy work better.

(CPA Journal--April, 1976)

Are Congressionally-Regulated Accounting Principles Desirable?

By Jerry J. Throckmorton, Wright State University, and Russell H. Hereth, University of Cincinnati.

Introduction

For years it has been generally assumed by its members that the accounting profession has the capability and the sense of responsibility to keep its house in order. It seems accountants believe the best method of adopting sound accounting principles is to be left alone to ponder, meditate and, after ample time, decide. Outside froces seem to muddle the issues and hinder the adoption of sound accounting principles. What surely must be considered least acceptable is for Congress or an agency appointed by Congress to dictate accounting principles.

To determine whether this "hands off" belief does persist among the members of the accounting profession, a questionnaire was developed and sent to 769 members of the AICPA to determine the opinions CPAs hold about several issues where Congressional interference has taken place or where there exists the strong possibility for Congressional interference. The areas covered in our questionnaire are inventory costing (LIFO), accounting for the investment tax credit, capitalization of leases and valuation of marketable securities. A brief review of these areas and the interference or possible interference follows.

Historical Perspective

LIFO. The Revenue Act of 1938 first permitted the use of the LIFO inventory method for tax purposes. However, the law permitted the use of LIFO for tax purposes only if also used for financial statement purposes. The use of LIFO became more widespread when the tax laws were somewhat liberalized and dollar value LIFO became acceptable. As inflation continued to accelerate in the 1960s and 1970s more firms switched to LIFO. In response to the tremendous upsurge of firms adopting LIFO during 1974, Revenue Bulletin 74-586 was released by the IRS in December. The Bulletin reiterates Section 472 of the Code of 1954 requiring the taxpayer to establish "to the satisfaction of the Secretary . . . that the taxpayer has used no procedure other than . . . [LIFO for reports or statements]. . . .

"1. To shareholders, partners or other proprietors, or to beneficiaries or

"2. For credit purposes."

The Bulletin also reminded the reader that subsequent to the adoption of LIFO any differences between LIFO and some other inventory method cannot be mentioned in such reports as the president's letter. In the LIFO situation Congress has demanded conformity and restricted the alternatives if LIFO is to be used for tax purposes. Some say the result has been acceptance by professional accountants, not because it makes good accounting sense, but because it produces the desired tax benefits.

Investment credit. Most readers will easily recall the problems the

investment tax credit has caused the profession. The controversy was started in 1962 when the Accounting Principles Board (APB) issued Opinion No. 2 requiring the credit be reflected in income over the life of the acquired assets. A split developed in the profession and the APB came back with Opinion No. 4 in 1964 stating that Opinion No. 2 was the preferable method for handling the tax credit but reflecting the credit in income in the year the asset was acquired (the flow-through method) is also acceptable. As a result the profession was criticized for not being more forceful in eliminating alternative methods of handling the credit. Again, in 1971 the APB prepared a proposed opinion which would have required that the benefits from the credit be spread over the life of the acquired assets. But before the opinion could be approved, Congress stated in December 1971 that no taxpayer shall be required to use, for purposes of financial reports subject to the jurisdiction of any federal agency or reports made to any federal agency, any particular method of accounting for the credit. The APB had to withdraw its proposed opinion and the hope of developing a uniform method of accounting for the investment tax credit was eradicated.

One cannot help but contrast the effect of Congressional action on inventory costing (LIFO) and accounting for the investment tax credit. In one case the effect was to prescribe a particular method and in the other to prevent a method from being prescribed. This inconsistency is particularly frustrating because the profession is frequently criticized for failing to reduce the number of alternative accounting methods.

Capitalization of leases. An area where prospective Congressional intervention may occur is in the treatment of lease liabilities. The pressure this time is to keep lease liabilities off the balance sheet. Letters have already been sent by legislators to the SEC and FASB opposing the capitalization of leases. The arguments to keep lease liabilities out of the heart of the financial statements are not based on sound theoretical accounting concepts. SEC Chief Accountant John C. Burton is quoted as stating "Those opposed (to lease capitalization) sense that they have lost the battle in the accounting profession, and they are now looking to Congress."

The major issue is not "good" financial reporting but "expedient" financial reporting. Representative Melvin Price (D-Illinois) states he hopes "that the decision would not be based on theoretical niceties of accounting principles. . . ." A statement such as the above leads one to wonder if accountants will be asked (forced) to report in a manner intended to manipulate the economy or in accordance with Congressional whims.

Marketable securities. The possibility for Congressional interference also exists in the area of marketable securities. Again, the reader will probably recall the attempts by the APB in 1971 and 1972 to draft an opinion which would have required the valuation of marketable securities at current market price. Some managements disagreed with this valuation method. A campaign followed which included letters to Congress and the SEC seeking their help in blocking action by the APB. Finally, the Board yielded to those desiring alternative methods for valuation of marketable securities. The FASB has now released an exposure draft again calling for valuation at market value.

There appears little doubt the logical theoretical basis for the valuation of marketable securities is

current market price. However in the light of declines in the market. numerous firms would show a large decrease in income if they were forced to value their marketable securities at market rather than cost. Hence pressures from management encourage accountants to permit a presentation based on something less than a sound theoretical foundation.

The Survey

If Congress becomes the sounding board for pressure groups desiring to change or perpetuate certain "accounting principles," the profession must also become a pressure group to interact with Congress. Referring to the lease liability issue, SEC Chief Accountant Burton stated "it is important that the Standards Board be prepared to make a case to Congress." Possibly this needs to be expanded and the members of the CPA profession need to become a political force, organized to confront Congress with persuasive arguments.

The questionnaire sent to members of the AICPA yielded a remarkable 54 percent response showing extremely strong opposition (approximately 80 percent) to Congressional action preventing the FASB from issuing statements in the area of marketable securities and capitalization of leases. There was also strong support (68 percent) for the repeal by Congress of the provision which prohibits the FASB from prescribing the method of accounting for the investment credit. A majority (but only 55 percent) of the respondents favored repeal of the LIFO restriction.

If accountants are opposed to Congressional interference, they should be equally opposed on all issues. We think that the variation exists in the case of LIFO. because it has recently been advocated so strongly as a way of minimizing the effects of inflation on reported earnings; and, in the case of the investment credit, because a substantial number opposed the proposed opinion (October 22, 1971) issued by the APB. Accountants seem to be somewhat biased in their attitudes toward Congressional interference by their opinions on specific issues (we are human after all).

Recommendations

It is evident, we believe, that the members of the AICPA do not want Congress to determine accounting principles by enumeration or prohibition. There is no evidence to indicate that a governmental body would do a better job (and some would point to the regulatory agencies as evidence to the contrary). It is also evident that the profession has not effectively conveyed its position, in respect to accounting principles, to our elected representatives. To be heard by Congress, we believe the members of our profession must become a political force, a political force to keep the politicians out of the accountants' precinct.

There appear to be two levels at which accountants can act. The first is before Congress and its committees. The voice of a clear-cut majority of accountants mandating an accounting principle should be well understood by and persuasive to politicians.

The second is at the grass roots level. Working from the information disseminated by the AICPA, and the various state societies, the profession must be active in the political arena. CPAs must make every effort to become personally familiar with elected representatives. We must find time to take part in letter-writing campaigns. Legislators could be asked to take part in panel discussions at professional meetings.

(CPA Journal, February, 1976)

A National Political Action Program for the Accounting Profession

Gilbert Simonetti, Jr.
Vice President-Government Relations
American Institute of Certified Public Accountants.

Why is it necessary for the accounting profession to have an effective national political action program?

What is meant by a national political action program—and how can such a program be made as effective as possible?

The accounting profession's need to be involved in national political action is as basic as the need of many other interest groups who would attempt to influence government policy. Representation of the viewpoints of specialized interests is an inseparable part of the American political process, with roots in the First Amendment guarantees of free speech and the right of the people "to petition their government for a redress of grievances."

Congress needs to consider interests which are not easily identified or traditionally recognized; Congress needs information, fairly furnished to be sure, but information which only a party whose interests are involved in the subject under consideration can produce. So long as representation is clear as to interest and honest in presentation, Congress will be aided if the points of view of all parties are fully developed.

The accounting profession has a distinctive role to fill in Washington. It is not just another interest group—it is a group of professionals with diversified skills that can make meaningful and constructive contributions in the development and implementation of government programs.

It can provide expert advice on a wide variety of public interest programs—and it can do so with impartiality.

And this leads me to the second question, that is, what is our profession's national political action program? Broadly speaking, the program consists of activities which fall into three categories:

First, public service or pro bono activities which harness the resources of the profession to provide its expertise on a variety of public interest matters.

Second, activities designed to recommend the use of CPA in government-sponsored programs such as federally-assisted grant programs.

Third, activities to prevent, modify or eliminate governmental actions which would be detrimental to the profession.

CPAs are in a unique position to observe the economic impact of both government and private sector decisions. They are called upon to an increasing degree to provide information essential for effective planning, control and decision-making by management, and to discharge the accountability of organizations and individuals to investors, creditors, government agencies, taxing authorities and others.

The increasing public interest in the professional practice of certified public accountants has placed the profession in a position which has enabled it to develop a keen awareness and understanding of the need for, and consequences of, government involvement in the private sector.

I believe CPAs are making meaningful contributions toward the resolution of some of the basic economic and social problems facing our country today. Through the Institute, representations are regularly made in such areas as taxation, social welfare and sound financial management.

It is the third category of activities in our political action program, that is, preventive or protective actions involving the profession's self-interest, that causes me the greatest concern about our ability to be effective on a continuing basis. It is the profession's self-interest activities that largely depend for effectiveness on "grass roots" support.

We are in a period in which the services provided by the accounting profession are taking on greater and greater economic significance, placing the profession in a more visible position to more and more segments of the public. This "new awareness" on the part of the public, and in particular the federal government as one major segment of the public, poses problems for the profession.

We are witnessing today a phenomenon which has been building gradually over the last decade; that is, a growing anti-business attitude on the part of Congress. Congress and the regulatory agencies have been exhibiting a heightened interest in the effects of corporate activity on our daily lives and CPAs, being closely associated with business, both large and small, are being caught in the web of suspicion surrounding business practices. As allegations are made and investigations are conducted concerning alleged improprieties by corporations and their managements, more and more attention is being focused on the CPA's responsibilities to the public and the way in which he is discharging them.

Issues relating to corporate frauds, corporate mismanagement, corporate practices of an illegal or questionable nature have led to the growing dimensions of the profession's legal liability problem. I believe that the accounting profession will need to seek legislative relief sometime in the not too distant future. This need will become more acute, if it is no longer possible to find underwriters willing to provide insurance at an acceptable cost. If and when a legislative solution is pursued, we had better be in a position to communicate our needs effectively to members of Congress.

Effective communication of the profession's needs, its self-interest needs, and effective communication to protect the interests of the profession from unfounded or unwarranted attacks will require an ability to work with a substantial number of Congressional representatives and their key staff assistants.

State societies can play an indispensible role in the profession's ability to be effective in providing needed "grass roots" support for positions of concern to the profession. I recognize that state societies are continually forced to make tough decisions about which programs will get immediate attention, which will be postponed and which will be abandoned. Time constraints and limitations on financial resources require the establishment of such priorities. However, I fear that unless there is some early reordering of our priorities for member involvement in the profession's national political action program, the accounting profession will not be in a position to be as effective as it must be in its own self-interest.

I would like to suggest for consideration several activities which I would hope state societies would pursue to enhance the ability of the profession to be effective.

1. Establish a regular ongoing key-man program for federal legislators. The "key-man" activity is an essential element in any political action program. It is the "core" around which a grass roots approach to resolving issues of concern to the profession is built. We need to identify members who can express the profession's views on issues directly affecting it.

My concern at this time is that there are not enough CPAs who can be designated as "key men," and thus we are limited in our ability to use that special assistance when it is needed. State societies have a significant role in nurturing existing relationships, and fostering new "key man" contacts with members of Congress.

2. Form a committee or other group of members to help the society coordinate its efforts with the Institute's office in Washington. Such a group could assist society officers and directors in following the course of legislative issues impacting on the profession. This is a vital function when time becomes important in determining how a society will react to legislative proposals.

3. Send copies of the state societies' magazines or newsletters to the members of the state Congressional delegation. Newsletters contain a great deal of valuable "intelligence" for the members' staffs. Most offices welcome receiving these communications which help keep them informed of matters and events taking place in their districts.

4. Every new state society president should establish, at minimum, a courtesy contact with his state's Congressional delegation. In the case of the states with larger delegations, it may be difficult to meet them all personally, but in any case, they should know that the CPA society in their state is interested in what their elected representatives are doing in Washington.

5. Volunteer the society's help to the members of the state Congressional delegation. What this entails is contacting one or more representatives of Congress and suggesting the establishment of an advisory panel of CPAs to provide assistance in evaluating proposals on which the accounting profession is in a position to comment. Certain legislators have created such panels, relying on individuals from their constituency to act as a "sounding board" on proposals on which the representative of Congress is considering taking a position. This would be particularly helpful to some of the newer members in Congress who are just beginning to establish strong ties in their districts.

6. Invite members of Congress to participate in state society programs and sponsor some form of social function for all or part of the Congressional delegation either in Washington or in a central location in the state. This will help maintain and enhance relations with members of Congress.

I have tried to suggest what I believe our Washington commitment means to CPAs. It is challenging and in the challenge is opportunity.

The accounting profession is moving in the direction of greater political awareness and involvement. The partnership between the Institute and state societies in coordinated actions cannot help but benefit the profession.

Today, the need to be aware of the effects of political decision-making has never been greater. It would be a critical error in judgment not to recognize the importance of actively participating in the process in order to have the profession's views considered on issues affecting it. The alternative is to acquiesce in the results of the deliberations which will continue whether or not the profession par-

ticipates. It is clear that tomorrow's decisions are based on the influence of today and that having recognized this important lesson, the profession will benefit from this increased awareness and commitment to a national political action program.Ω

(CPA Journal, March, 1976)

Looking to the Future

Louis M. Kessler, CPA
Senior Partner of Alexander Grant & Company. He was a member of the Accounting Principles Board and is a past president of the AICPA. In 1975 Mr. Kessler was awarded the Institute's Gold Medal for service to the profession.

In a speech at the C.W. Post School of Professional Accounting in December 1975, I reviewed major professional accounting developments of the last five years in three broad categories: principles and standards, professional practice and professional organization. I also reviewed the history of the APB, FASB contributions to date, SEC participation, important developments in the AICPA and some of the proposals presently being advanced concerning structure and self-regulation of the profession.

In concluding my talk, I made a number of exhortations and recommendations for future thought and action that I believe warrant careful consideration by those who will have the responsibility for charting the future course of our profession.

These closing remarks, categorized under the same headings as the last five years' history, follow.

Principles and Standards

1. Strive to keep the setting of principles and standards in the private sector—at all costs.

2. We are adding disclosure requirements upon disclosure requirements until we may be "disclosure happy." Like the establishment of government agencies we keep adding new ones but never seem to eliminate old ones.

I remember when disclosure of sales and cost of sales was considered revolutionary. That is a far cry from this era of disclosure of secret files, political contributions and CIA activities.

More disclosure, however, is not necessarily good disclosure, and when a CPA examines and reports on financial statements the requirements are the same if the client is Conglomerated Multinational Enterprises, Inc. or Mom and Pop's Franchised Fast Food Palace. When APB No. 15 was being prepared I tried in vain to get an exemption for closely-held companies. When mom and pop own all the stock it seems a bit ridiculous to show net income of $28,755 and earnings per share (both primary and fully diluted) of $287.55. So strive for a modification of disclosure requirements under GAAP, perhaps eliminating some altogether and/or providing for two categories, those for across-the-board use and those (possibly called supplemental disclosures) for only those companies having, for example, more than 25 shareholders.

3. Consistent with disclosure simplification there should be a simplification of GAAP for certain situations. Examples of measurement principles which cause problems are deferred tax accounting, equity method of accounting, imputation of interest and lease capitalization. Furthermore, the proposed FASB statement on price-level accounting would require presentation of price-level-adjusted financial information as a supplement to basic annual statements for all companies, large and small, public and nonpublic. So strive for a simplification of GAAP for small and/or closely-held businesses.

4. Consistent with disclosure and GAAP simplification, there is a need for some additional latitude for unaudited financial statements. For example, the profession's literature could be changed to permit issuance of statements for use by third parties omitting all GAAP disclosures if such statements were accompanied by an appropriate caveat. Fortunately, a standing committee has just been appointed within the Auditing Standards Division of the Institute with the following objective, among others: "To reconsider all aspects of AICPA pronouncements applicable to the association of CPAs with unaudited financial statements." So strive for a clarification and simplification of these requirements.

5. The thorny problem of leases is very much with us and will not go away. The proposed FASB statement would supersede APB Opinions 5, 7, 27 and 31, and that is all to the good. The subject should be dealt with in one place and should set forth the accounting by both lessees and lessors. A clear-cut distinction between a capital lease and an operating lease is difficult, and I am not sure the exposure draft does it all. The requirement to disclose for operating leases of more than one year "the *present value* of minimum future rental payments by major property categories" is a tough one. In APB No. 31 we made this optional, but then the SEC came along and made it mandatory, albeit only for companies subject to its jurisdiction. So strive to get the lease questions resolved, but here again keep in mind the small and/or closely-held companies.

6. Financial reporting for segments of a business enterprise is another subject that will not go away. Bob Mautz made a thorough study of the subject some time ago for the Financial Executives Institute. Here again in an FASB exposure draft, we have significant disclosure requirements proposed for large and small businesses alike. Perhaps some of this should wait until the FASB defines the objectives of disclosure generally, as a part of its conceptual framework project. Furthermore, I question the need for applying these disclosures to interim financial statements or to statements of financial position only. So strive for reasonableness in the requirements for disclosure of segmental information.

7. "Accounting for inflation." You should be aware of the following:

—Accounting Research Study No. 6 entitled "Reporting the Financial Effects of Price-Level Changes."

—APB Statement No. 3 "Financial Statements Restated for General Price-Level Changes."

—ASR No. 151, issued in January 1974, requesting voluntary disclosure of "inventory profits."

—FASB exposure draft, issued December 31, 1974, on "Financial Reporting in Units of General Purchasing Power."

—A 364-page report, issued in London on June 25, 1975, by a committee on inflation accounting, commonly referred to as "The Sandilands Report."

—SEC Release 33-5608, issued August 21, 1975, proposing to require disclosure of certain replacement cost data in notes to financial statements.

With my basic accounting education in the 1930s, I was steeped in the sanctity of original cost and measurement by verifiable objective evidence. I was aware of the excesses and the appraisal write-ups of the 1920s which contributed to the depression of the early 1930s. But original cost is no longer sacred and, with our spiraling inflation, does not tell the whole story, so one can expect an entirely new ball game. We are far from a decision on the rules, however. In

my opinion, the FASB proposal for general purchasing power financial information based on the GNP Implicit Price Deflator (again for all companies, large and small) does not fill the bill and may be a complex exercise in frustration. The SEC proposes limited disclosure of replacement cost data and does not believe that general price-level reporting adequately addresses this issue. The Sandilands Report does not favor current purchasing power supplemental statements and recommends a system of "current cost accounting" to be mandatory for listed companies and other large companies for accounting periods beginning not later than December 24, 1977, if feasible. Note the implication that small companies should wait until the larger ones get geared up.

Personally, I feel that we should wait until we can get this all sorted out and, hopefully, get the IRS and the Congress to take some cognizance of current value accounting in the tax laws and regulations as is the case in Brazil and Chile, for example. So my only suggestion is that you get ready to account for inflation.

Professional Practice

8. Strive for a mitigation of accountants' legal liability; support the efforts being directed toward quality control programs; strive to educate the public on auditors' responsibilities.

Professional Organization

9. Support the program for accreditation of specialists; carefully consider the possibility of some kind of Institute membership for non-CPAs employed in a professional capacity by CPA firms; strive for common membership in the AICPA and the state societies; strive for a national CPA certificate issued by the Institute, with licenses to practice controlled by the several states.

Finally, strive for the establishment of more professional schools of accountancy.Ω

AICPA

American Institute of Certified Public Accountants
1620 Eye Street, N.W., Washington, D.C 20006 (202) 872-8190

July 9, 1975

The Honorable H. John Heinz, III
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Heinz:

Thank you for your interest with a matter of particular concern to the accounting profession.

At issue is an amendment that was added to the Dingell energy bill, HR 7014, during the final markup session by the Interstate and Foreign Commerce Committee. That amendment, offered by Representative John Moss of California, would establish a new "Office of Petroleum Accounting and Auditing (OPAA)" within the General Accounting Office (GAO) to conduct financial audits of certain companies in the petroleum industry. In addition to the audit function, the OPAA would be required to prescribe "standards for uniform accounting practices for the petroleum industry."

It is our understanding that very little time was spent discussing the merits of the Moss amendment prior to its acceptance. In particular, nowhere is it indicated what view the Securities and Exchange Commission holds with respect to the standards-setting provision. We would be quite surprised if in fact the SEC endorsed this provision, since it is a direct intrusion into a specific area of its responsibility and authority under the Securities laws.

We feel that on such an important issue, the views of all concerned, government agencies as well as the private sector, should have been formally solicited and examined prior to the Committee's consideration of the amendment. To our knowledge this was not done in this instance.

It is for this reason that we have called on you to request the Chairman of the Securities and Exchange Commission, Mr. Ray Garrett, Jr., to express the Commission's views on the Moss amendment to HR 7014, particularly that part relating to the establishment of accounting principles by the General Accounting Office.

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Since this matter directly affects the work of the SEC, the Commission's views on this precedent-setting issue should be available to all the members before they consider the bill on the House floor.

My office is ready to be of whatever assistance you may need with respect to this matter.

Sincerely,

Gil Simonetti, Jr.

Gilbert Simonetti, Jr.
Vice President
Government Relations

GS:pp

AICPA

American Institute of Certified Public Accountants
1620 Eye Street, N.W., Washington, D.C. 20006 (202) 872-8190

July 15, 1975

The Honorable Philip A. Hart
Chairman, Subcommittee on Anti-Trust
and Monopoly of the Committee on the
Judiciary
253 Rayburn Senate Office Building
Washington, D.C. 20510

Dear Senator Hart:

The American Institute of Certified Public Accountants is the sole national professional society representing more than 110,000 of our nation's certified public accountants. Chief among its functions is the assistance provided directly by the AICPA to the development and application of accounting principles.

In that respect, our Committee on Federal Trade Commission Matters recently reviewed S.1284, "Antitrust Improvements Act of 1975," particularly Title V--Premerger Notification. Based upon this review, I am writing to express the views of the Committee members on the need for revision of Section 501. Other portions of the proposed legislation do not appear to pertain to accounting or auditing matters, and therefore our comments will be addressed solely to the provisions contained in Title V.

Section 501 would amend the Clayton Act of 1914 (15 USC 12) by adding a new Section 23 to the Act requiring "premerger notification" involving corporate acquisitions meeting certain conditions. More specifically, Subsection 23(b)(4) provides

> "(4) The Federal Trade Commission, after consultation with the Assistant Attorney General, is authorized and directed to define the terms used in this section, prescribe accounting methods for reporting thereunder (emphasis supplied), by general regulation except classes of persons and transactions from the notification requirements thereunder, and to promulgate rules of general or special applicability as may be necessary or proper to the administration of this section, insofar as such action is not inconsistent with the purposes of this section, after notice and submission of views, pursuant to section 553 of title 5, United States Code."

Establishment of Accounting Methods

The proposed assignment to the Federal Trade Commission (FTC) of responsibility to set accounting methods has, we believe, been made without due regard to the Federal Securities Laws which charge the Securities and Exchange Commission (SEC) with this function. The statutes presently administered by the SEC have the general objective of providing the fullest possible disclosure to protect investors and the public against malpractices in the securities and financial markets. The SEC, since its establishment in 1934, has set into motion a most successful mechanism to accomplish the complex task of setting accounting and disclosure standards. Over the years it has utilized, to the fullest extent possible, the time and talent of the leaders of the accounting profession in carrying out this function.

The SEC has recognized from the beginning that the task of improving financial accounting standards is one of great complexity, demanding large expenditures of time and talent. Also, the SEC is aware that it would be fiscally impractical for a public agency to develop an accounting staff large enough to continually research accounting problems and also meet day to day administrative demands. As a result a large contribution to this effort is made by the Financial Accounting Standards Board, the non-profit institution organized to establish accounting principles.

We also are concerned that such a provision may lead to requirements that an entity use different accounting methods for reporting to the FTC than are used in reporting to the SEC and the public. In our opinion such a difference cannot be justified for prenotification purposes and could be extremely costly to private enterprise when acquisitions are being considered.

Accordingly, we suggest that paragraph (4) of subsection 23(b) be amended by deleting the clause "prescribe accounting methods for reporting thereunder". We feel that any such phrase is unnecessary as companies will typically report on the same basis as records are kept and financial statements prepared. Thus, any confusion as to the possibility of dual accounting and reporting is thereby eliminated.

Defining Acquisitions

We note that Section 23(a) as proposed provides that any acquisition of assets in excess of $10,000,000, from one corporation or other person, by a person with assets in excess of $100,000,000 must be reported 60 days in advance of the transaction. While it appears that the intent of this provision is to provide only for sale of a business, it is not unusual for large corporations to engage in transactions in the normal course of business in which the value of property acquired exceeds $10,000,000. We therefore suggest that some phrase such as "(not being sold or acquired in the normal course of business)" be inserted in the relevant portion of the Bill.

De Minimis Provisions

We also note that any transaction which meets the terms of Section 23(a)(1) would also meet the terms of Section 23(a)(2). Since it appears that it is the intent to provide a de minimis limit for a business being acquired, and since we assume that it is intended that only those assets of the seller that are transferred should be used in determining whether the transaction should be considered as being subject to the pre-notification requirements, we suggest that lines 10 through 19 on page 25 of the Bill be changed to provide (1) that the combined total assets of the acquiring person or persons and the stock or assets being acquired, or the annual net sales attributable to such combined total assets, are in excess of $X, and (2) that the stock or assets being acquired represent total assets or annual net sales attributable thereto in excess of $Y. Our Committee does not have an opinion as to the amounts to be inserted at X and Y above. The amounts from the Bill would be $100,000,000 and $10,000,000 respectively.

* * * * * * * *

We believe that it would be desirable to discuss more fully the views expressed in this letter with you and members of your staff. Therefore, we respectfully request that a meeting be arranged in the near future between representatives of the AICPA's Committee on Federal Trade Commission Matters and you or your representatives.

Sincerely yours,

William T. Barnes

William T. Barnes
Chairman, Federal Government
Division

cc: Subcommittee on Anti-Trust and Monopoly
Gilbert Simonetti, Jr., Vice President,
Government Relations
Thomas R. Hanley, Director,
Federal Government Division

AICPA

American Institute of Certified Public Accountants
1620 Eye Street, N.W., Washington, D.C. 20006 (202) 872-8190

September 4, 1975

The Honorable John E. Moss
U.S. House of Representatives
2354 Rayburn House Office Building
Washington, D. C. 20515

Dear Mr. Moss:

The American Institute of Certified Public Accountants, the national organization representing more than 110,000 certified public accountants has studied your amendment of Title VIII of H.R. 7014, concerning the compilation and auditing of energy information, as published in the Congressional Record of July 31, 1975.

In principle, the Institute is opposed to the adoption of Title VIII. The provisions of Title VIII, if enacted, will result in a significant impact on both the public and private sectors. Because of the attention which has centered on several other significant sections of H.R. 7014, we believe the provisions of Title VIII have not received adequate consideration. Thus, it is our position that if Congress determines that a more effective system is needed for the compilation of an energy data base, a separate legislative proposal should be drawn so that it can be considered on its own merit.

While we appreciate the changes reflected in the July 31 amendment to Title VIII, we respectfully urge that further modifications be made in Title VIII if it is to be considered by the House of Representatives as a part of H.R. 7014.

The amendment does not overcome three major problems:

First, the provision (Sec. 801(b)) permitting the Comptroller General to conduct verification audits of the financial statements of any vertically integrated petroleum company filed with the Securities and Exchange Commission will result in needless and costly duplication of effort since such financial statements are now audited by independent public accountants as prescribed by the Securities Act of 1933 and the rules of the SEC.

Second, the provision (Sec. 803(a)) requiring the SEC to prescribe accounting practices for the petroleum industry will destroy the effective relationship which has existed for more then forty years between the public and private sectors in the development of generally accepted accounting standards.

Third, the provision (Sec. 803(c)) specifying particular data needs is impracticable.

We believe that with further modifications the objectives of your amendment can be achieved more efficiently and economically and will preserve the integrity of the long-standing effective relationship which has existed between the public and private sectors in both the auditing process and the establishment of accounting standards. Following, on a section-by-section basis, are our recommendations for further modification of your amendment.

Section 801

Sec. 801 should be modified to provide the Comptroller General the means by which he could exercise his responsibility to conduct verification audits in the petroleum industry in the most efficient and cost effective manner.

As presently worded the July 31 amendment to Title VIII would result in extremely costly audits of financial statements of petroleum companies by the Comptroller General which are duplicative of audits of such financial statements conducted by independent public accountants. We believe that the specific reference to the conduct by the Comptroller General of verification audits of the financial statements of petroleum companies filed with the SEC is unnecessary and should be deleted. However, with other modifications which we recommend, the Comptroller General would continue to have the discretion either to conduct such audits or to rely on the work already done by independent public accountants. This approach would result in a more efficient and economical utilization of audit resources.

Our specific recommendations for change in Sec. 801 are as follows:

1. Sec. 801(a) - The opening clause should be reworded as follows:

   "The Comptroller General is authorized to conduct verification audits, under such rules and regulations as he may prescribe, with respect to the books and records of . . ."

2. Sec. 801(b) - This subsection, dealing with financial statements filed with the SEC, should be deleted.

3. Sec. 801(c) - This subsection should be renumbered Sec. 801(b) and revised as follows:

   "The Comptroller General shall conduct verification audits, under such rules and regulations as he may prescribe and within the limits of reasonably available resources as determined by him, of any person described in subsection (a) if requested to do so by any duly established committee or subcommittee of the Congress having legislative or investigative jurisdiction."

4. Sec. 801(d)(1) - The following sentence should be added to the definition of the term "verification audit":

   "In determining the scope of examination necessary to determine the accuracy, reliability, and adequacy of energy information furnished, the Comptroller General may give due consideration to the work of independent public accountants and, in his discretion, may rely upon such work."

5. Sec. 801(d)(5) - The definition of the term "financial statement" should be deleted.

We understand that the foregoing recommendations are consistent with those made by Comptroller General Elmer B. Staats and SEC Chairman, Ray Garrett, Jr. Mr. Staats in his July 30, 1975 letter to Rep. John D. Dingell, expressed particular concern about the potential enormity of the responsibilities that would be assigned to the GAO and the need for GAO to be flexible in the employment of its "reasonably available resources" to carry out its responsibilities. Mr. Garrett in his letter of August 22 to Mr. Frank G. Zarb, Administrator of the Federal Energy Administration expressed strong opposition to extension of the auditing responsibility of the Comptroller General to include audits of financial statements of petroleum companies filed with the SEC.

Section 803

We agree that Congress should be assured that uniform accounting standards are developed for the petroleum industry within a reasonable period of time. On the other hand, we do oppose the concept expressed in Sec. 803(a) that the SEC be directed to establish such standards and practices by rule or that the means of such establishment should be prescribed.

The SEC has worked closely with the accounting profession and with the business and academic communities to develop an accounting standard-setting procedure. We believe that this cooperative effort has been beneficial to investors and other users of financial statements. We see no reason why accounting standards for the petroleum industry cannot be promulgated by the Financial Accounting Standards Board. This would preserve the spirit of cooperation between the public and private sectors which has served the public well over more than forty years.

We concur with the following significant observations made by SEC Chairman Ray Garrett in his letter to Mr. Zarb:

> "We believe strongly that the current standard-setting apparatus is a good one and should not be upset. Because the FASB is a recently created organization, care must be taken that its credibility is not eroded. We believe that a statutorily required governmental rulemaking procedure at this time to establish accounting standards by rule would seriously impair the effectiveness of the Board.
>
> "The Commission is confident that adequate accounting standards can be achieved by the FASB in the oil and gas area within three years with the cooperation of the Commission and under its broad oversight, consistent with its policy of supporting the FASB articulated in the Commission's Accounting Series Release No. 150."

In addition we recommend that Sec. 803(c), specifying particular data requirements, be modified so that the data needs are expressed in terms of objectives. The present detailed prescription of the manner in which certain energy information is to be provided is impracticable.

It appears that the intention of Sec. 803(c) is to require the SEC to prescribe specific rules in order to develop a data base constructed on prescribed lines of business. Major integrated petroleum companies are highly complex and their operations contemplate the development of products on a continuous process basis. The nature of their operations tend to be unitary, regardless of the variety of end products. In view of the unitary nature of operations in this industry, it seems highly unlikely that there can be a meaningful (and comparable) breakdown of capital, revenue and operating cost information pertaining to prospecting, acquisition, exploration, development and production.

It is true that petroleum companies have, and are continuing to work toward the determination of the costs which can be ascribed to particular areas of operation. However, this remains in the development stage. Keeping in mind the complexity of the problems to be dealt with, much more experimentation is needed before anything approaching uniform reporting methodology for particular areas of operations can be prescribed.

We believe a more meaningful approach to the problem of developing an appropriate energy data base is to permit those who establish the accounting standards to develop the elements of a data base which will meet Congressional objectives.

Our specific recommendations for change in Sec. 803 are as follows:

1. Sec. 803(a) - This subsection should be reworded as follows:

   "For purposes of developing a reliable energy data base related to the production of crude oil and natural gas, the Securities and Exchange Commission shall initiate the development of accounting standards to be followed in the preparation of financial statements by persons engaged, in whole or in part, in the production of crude oil or natural gas in the United States. Such standards shall be developed not later than thirty-six months after the date of enactment of this Act."

2. Sec. 803(b)(2) - This provision should be reworded as follows:

   "The Commission shall, consistant with its policy, seek the advice and assistance of the Financial Accounting Standards Board in the development of such accounting standards."

3. Sec. 803(c) - The opening clause should be reworded as follows:

   "The Commission shall require observances of accounting practices to be followed in the preparation of financial statements which, to the greatest extent practicable, permit the compilation, treating domestic and foreign operations as separate categories, of an energy data base consisting of relevant operating revenue and cost information including:"

4. Sec. 803(c)(1) - This provision, specifying elements of the energy data base, should be deleted.

5. Sec. 803(c)(2) and (3) - These provisions, concerning selected elements of the energy data base, should be renumbered as Secs. 803(c)(1) and (2) respectively.

We would be pleased to provide you with any clarification or amplification of our views which you may require or to meet with you or your staff to discuss the issues more fully.

Very truly yours,

Philip L. Defliese

Philip L. Defliese
Chairman of the Board

cc: The Hon. Harley O. Staggers
The Hon. John D. Dingell
Other Members of the Committee on
Interstate and Foreign Commerce

AICPA American Institute of Certified Public Accountants

FEDERAL TAX DIVISION

of the

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Statement
on
Estate and Gift Tax Reform

Submitted to
The Committee on Ways and Means
of the
U.S. House of Representatives

March 15, 1976

Synopsis

of AICPA Position

The American Institute of Certified Public Accountants supports estate and gift tax reform legislation in the following key areas:

1. Generation-Skipping Transfers. Under current law, an individual can make a transfer of property to a descendant two generations removed and, so long as intervening generations are limited to a mere economic interest (i.e., an income interest), no estate or gift tax is imposed on the intervening generation. We recommend:

- No imposition of tax on outright transfers benefitting a "skipped" generation;
- Imposition of a tax on creation of inter vivos and testamentary trusts which benefit a skipped generation;
- Basing such tax on actuarially determined values;
- Imposing such tax on the estate of the skipped generation and making it payable from trust corpus, and;
- A liberal disclaimer provision and extension of the previously taxed property tax credit for a period of up to 25 years.

2. The Marital Deduction. Under present law a decedent may transfer up to one half of his estate to his spouse free of tax so long as the interest transferred does not lapse because of the passage of time or occurance of certain events ("terminable interest rule"). We recommend:

- Retention of the 50 percent marital deduction limitation;
- Retention of the terminable interest rule, and;

- As stated below, an exemption level of $150,000 which would permit a $300,000 estate to pass free of tax.

3. Appreciated Assets Transferred at Death. At present, where a decedent dies owning appreciated assets, the appreciation is not subject to the income tax, and the beneficiaries take a basis in the property received equal to its fair market value. We recommend retention of our present system in this area.

4. Unified Transfer Tax. There currently exists an exemption from the estate tax of $60,000, and a lifetime gift tax exemption of $30,000 per donor. In addition, there is an annual exclusion of $3,000 for each donee for gifts of present interests. We recommend:

- Unification of these two systems of transfer taxes;
- Retention of the present estate and gift tax rates;
- That upon death, there be included in the estate tax computation 75 percent of the fair market value of inter vivos gifts made;
- Allowance of a credit for gift taxes paid on inter vivos gifts;
- Retention of the $3,000 annual gift tax exclusion; and,
- Increasing to $150,000 the current combined $90,000 exemption for estate and gift taxes.

5. Liberalization of Deferred Payment of Federal Estate Tax. Under present law, an extension of time to pay the federal estate tax may be granted in two situations: 1) where payment of the tax would result in "undue hardship" to the estate (Section 6161); 2) where the estate consists largely of an interest in a closely held business (Section 6166). In addition, Section 303 permits

certain redemption distributions to be made to help in paying the estate tax, without certain adverse income tax consequences.

We recommend:

- Treatment as a single corporation, for both Sections 303 and 6166 purposes, a decedent's interest in two or more corporations if the estate owns more than 50 percent of each;
- No change in the amount of redemption proceeds qualifying under Section 303;
- Liberalization of ownership requirements in connection with the payment of estate taxes where an estate consists largely of an interest in a closely held business, and;
- Liberalization of Section 6161 with regard to extensions of time for payment of the tax.

AICPA American Institute of Certified Public Accountants

FEDERAL TAX DIVISION

of the

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Statement
on
Tax Revision
(HR 10612)

Submitted to
The Committee on Finance
of the
United States Senate

March 18, 1976

Summary Statement

Capital Formation

The Institute believes that the most urgent factor that must be considered in the current tax reform hearings is the impact of the tax system on capital formation and the preservation of existing capital. We have previously testified on the importance of accelerated depreciation and the investment tax credit in preserving capital for business entities. With the rate of inflation experienced in the last few years, continuation of these provisions is essential and, if anything, should be expanded. Neither depreciation nor the investment credit fully offset the erosion of capital investment caused by inflation, but they do provide some relief.

The Institute has issued a series of Statements of Tax Policy which bear upon capital formation. The subjects of these individual statements are:

1. Taxation of Capital Gains
2. Value-Added Tax
3. Elimination of the Double Tax on Dividends
4. Estate and Gift Tax Reform

We would be pleased to make copies of these statements available to you. They are described in more detail on the following pages and have provided much of the background material included in this statement.

Capital Gains and Losses

After careful consideration of the impact of inflation, the need for capital formation, and the retention of incentives for investment, it is the Institute's view that continuation of the present rules for taxing capital gains is desirable, subject to certain suggestions for modification.

With regard to capital gains, we recommend legislation that would:

- Extend the holding period requirement from more than 6 months to more than 12 months.
- Provide a sliding scale of exclusions for longer holding periods.
- Extend the capital loss carryback provisions to individual taxpayers.
- Increase the $1,000 limitation on deductibility of net capital losses against ordinary income.

These recommendations and additional background material are included in our Statement of Tax Policy - Taxation of Capital Gains.

Elimination of the Double Tax on Dividends

Our traditional system of imposing at least two levels of taxation on corporate earnings creates a bias against investment and encourages consumption. A number of other highly industrialized countries have recognized this problem and have changed their tax laws to reduce or eliminate the double tax effect.

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The Institute recommends that serious consideration be given to the integration of corporate and individual income taxes with the objective of permitting either a dividends-paid deduction to the corporate entity, or some form of tax credit to the individual shareholder when dividends are paid.

These proposals and several other alternatives are discussed in detail in our Statement of Tax Policy - Elimination of the Double Tax on Dividends.

Foreign Source Income

The Institute does not favor any change in the present treatment of unremitted foreign earnings. We support continuation of the foreign tax credit, rather than treating foreign taxes as deductions for U.S. tax purposes.

The Institute supports the Administration proposal that withholding on foreign investment in United States securities investments should be eliminated.

We do not agree with the House of Representatives decision to eliminate the earned income exclusion under Section 911. This would create a further disadvantage for many U.S. companies competing abroad.

Small Business Tax Problems and Certain Expiring Provisions of PL 94-164

Corporate Tax Rates. The Institute agrees that reduction of the corporate tax rate provides a stimulus to the economy and is helpful to small business. Accordingly, we support extension of the corporate rate reductions which were extended until June 30, 1976, by the Revenue Adjustment Act of 1975 (PL 94-164).

Investment Tax Credit. The Institute agrees with the provisions of HR 10612 extending until 1980 the temporary increase in the credit to 10 percent and also agrees with the temporary increase to $100,000 in the maximum amount of used property qualifying for the credit. The investment tax credit should be made permanent to provide certainty for business planning.

Estate Tax Problems. The Institute has recently completed a Statement of Tax Policy on Estate and Gift Tax Reform. This policy statement, which will be distributed to members of your Committee, is contained in the Committee Print of Background Material on Federal Estate and Gift Tax Reform of the Ways and Means Committee dated March 8, 1976. The policy statement provides an indepth analysis of the AICPA positions concerning:

- Generation-Skipping Transfers
- The Marital Deduction
- Appreciated Assets Transferred at Death
- Unified Transfer Tax
- Liberalization of Deferred Payment of Federal Estate Tax.

However, we believe there is little likelihood that comprehensive estate and gift tax reform can be accomplished during this session of Congress. As an interim measure, we generally favor the proposals included in the Estate and Gift Tax Reform Act (S 2819) and S 2394 which would increase the estate tax exemption and extend the time for payment of estate taxes.

We also direct your attention to the increase in interest charged on deferred estate taxes as a result of the passage of PL 93-625. We urge that this rate be restored to its prior level of 2/3 of the regular rate on tax deficiencies.

Regulation of Income Tax Return Preparers

The Institute agrees that there have been improprieties associated with advertising by commercial tax return preparers and problems with preparers who are incompetent or unethical.

The Institute does not believe that regulation is needed for professional preparers such as attorneys and Certified Public Accountan
In general, we support the approach adopted in HR 10612 as a practical and workable solution which would provide the Internal Revenue Service with adequate capability to oversee income tax return preparers.

<u>Disclosure of Private Rulings</u> (Section 1212 of HR 10612)

Section 1212 of HR 10612 prescribes conditions under which past and future private rulings will be made available to the public. Discussions have been held involving representatives of the Internal Revenue Service, Tax Analysts and Advocates, the Public Citizen Litigation Group, the Tax Section of the American Bar Association, and the AICPA, with the objective of reconciling different viewpoints.

Litigation of the private rulings issue under the Freedom of Information Act is presently before the courts. In our view, the matter should be resolved by legislation within the framework of the Internal Revenue Code.

While we support the concepts of Section 1212 of HR 10612, we believe the legislation would be improved if it incorporated the recommendations of the parties listed above. These recommendations can be found in a Memorandum of Understanding dated March 4, 1976 and published in the March 15, 1976 issue of <u>Tax Notes</u>.

<u>Limited Technical Matters</u> (Title XIX of HR 10612)

The so-called Deadwood Bill has come before Congress for consideration previously, but was never enacted. We urge your Committee, during this major reform effort, to give serious consideration to these non-controversial proposals now contained in Title XIX of HR 10612.

In addition, the Institute has prepared a booklet entitled "Recommended Tax Law Changes" which contains many technical recommendations that would eliminate unintended benefits and hardships. This booklet has previously been distributed to your Committee and to all members of Congress. We would be pleased to discuss the recommendations contained therein which we hope will provide greater equity and simplification.

AICPA American Institute of Certified Public Accountants
1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

July 23, 1976

To AICPA Council Members
in Alabama, Florida, Georgia,
North Carolina, South Carolina,
Tennessee, Virgin Islands,
Virginia and West Virginia

During the past several months, the tempo of activities in Congress that have a direct bearing on the accounting profession have increased at an alarming rate. While it is not possible to accurately predict the likely course of future events we believe that 1977, following the opening of a new session of Congress, will be a critical period for the future of our profession.

There are many current developments which cause us to be alarmed about the possibility of governmental intervention in the profession's affairs. Much of the present interest in Washington comes from a concern about corporate accountability and an environment that is anti-business. The profession is viewed as a means of dealing with the perceived need for greater accountability.

This heightened awareness of the critical part the profession plays in the management of our economy could result in substantial changes in our historical structure, role and responsibilities. Because these are developments that would be perilous to ignore, it is imperative that the Council be fully informed and assist us in a plan of action to respond.

Therefore, with the concurrence of the Board of Directors, we are arranging a set of regional meetings of Council members to be held during the latter part of August. These meetings will serve a dual purpose: to inform you of the developments and to seek your guidance on how to proceed.

In our judgment, holding the meetings on such short notice and during a heavy vacation period is advisable. We feel that we must act quickly to allow time for members to give careful thought to the issues before action must be taken.

Much of the Congressional activity will begin next February or March and we must be prepared to act effectively at that

time. An important part of our program will be a key-man program in every state so that the profession's views can be effectively communicated by CPAs to their representatives in Congress. Therefore, we have decided to invite the State Society Executives to participate in the regional meetings.

You are cordially invited to attend the regional Council meeting at the Atlanta Marriott Motor hotel in Atlanta, Georgia on August 25, 1976. The meeting will begin at 9:00 AM and is expected to adjourn around 3:00 PM. Please return the enclosed card at your earliest convenience indicating whether or not you can be present. We have reserved room accommodations at the hotel and enclose a reservation card which should be completed and returned to the hotel.

In order to maintain balance in the size of groups, we would prefer that you attend the above meeting. However, if you cannot make that one, please consider attending one of the other scheduled meetings shown on the attached sheet. In any event, please let us know of your plans.

Shortly, we will be sending you an agenda for the meeting. I recognize the meeting is called on short notice and may involve modification of your vacation plans, but we have little choice if we are to deal effectively and on a timely basis with the important recent developments which face our profession.

Sincerely yours,

Ivan Bull

Ivan Bull
Chairman of the Board

Encs.

IB:jh

SCHEDULE OF REGIONAL COUNCIL MEETINGS

AUGUST 11, 1976

Dallas, Texas
Airport Marina Hotel

AUGUST 12, 1976

Los Angeles, California
Los Angeles Marriott Hotel

AUGUST 24, 1976

Chicago, Illinois
Marriott O'Hare Hotel

AUGUST 25, 1976

Atlanta, Georgia
Atlanta Marriott Hotel

AUGUST 30, 1976

Philadelphia, Pennsylvania
University City Holiday Inn

AUGUST 31, 1976

New York, New York
Waldorf Astoria Hotel

From AICPA's Professional Standards--
Ethics and Bylaws as of Sept. 1, 1974

BL Section 911

Objectives of the American Institute of Certified Public Accounts

.01 *Note:* The following statement of the Institute's objectives reflects a series of actions by Council over the last decade. The objectives set forth here supplement, or in some cases amplify, the opening paragraph of the bylaws devoted to the purposes of the organization.

- To sustain itself as an organization of distinction by the wide participation of its members, by the intense and creative involvement of the best of the profession in Institute affairs, and by an exceptional quality of staff performance.
- To adopt a form of organization best designed to meet the needs of all its members both in and out of practice.
- To engage a full-time staff of sufficient size and competence and to organize their efforts—both in terms of direct staff work and assistance to committees—so that the organization can move with speed and precision to continually strengthen its service and its leadership.
- To perform in a manner which will persuade all parties at interest —government, financial institutions, the business community, universities and the public generally—to accept the organization as the authoritative source of principles and procedures in its field.
- To promote improvements in financial reporting by seeking to eliminate variations in reporting practices which are not justified by substantial differences in circumstances.
- To communicate effectively to the public, as well as to all levels of government, in regard to matters of concern to the profession.
- To produce valuable, new knowledge in its field through research and experimentation, the analysis and synthesis of experience, and the development and adaptation of new techniques.
- To identify those areas in society where the need for the CPA's attest function exists and to assist its members in equipping themselves to

perform the attest function wherever a useful social purpose would be served.

- To maintain surveillance over practice in the interest of promoting high standards of performance by the profession and public confidence in its work.

- To promote the adoption of uniform, nationwide standards governing the issuance of CPA certificates, recognition of qualified accountants of other countries, and freedom of movement in interstate and international accounting practice.

- To serve as a constructive force in improving education for the profession and, ultimately, all business education.

- To encourage a continuous restatement of those areas of knowledge and technical competence required by the CPA in his present and prospective professional practice, and a clarification of the responsibilities appropriate to universities, practitioners, and professional societies in the education and training of CPAs.

- To maintain a high level of quality in its publications and in its program of professional development, and thus to aid its members in discharging their commitment as professional men to a lifetime of study and self-improvement.

- To coordinate, on a voluntary basis, the plans, programs, and activities of the state societies and of the Institute, with particular emphasis on the adoption of uniform codes of professional ethics and enforcement procedures.

- To cooperate fully with all organizations of accountants, both at home and abroad, to the end that the entire accounting function can make its maximum contribution to the public good.

- To encourage every eligible CPA, in furtherance of his personal development and in fulfillment of his professional obligations, to become a member of both his state society and the Institute.

- To encourage all CPAs to perform a wide range of services in the broad field of accounting consistent with their professional competence and their ethical responsibilities. *(See BL section 921, "A Description of the Professional Practice of Certified Public Accountants" which was approved by Council in 1966 as an official statement of Institute policy.)*

The next page is 6031.

BL Section 921

A Description of the Professional Practice of Certified Public Accountants

.01 Certified public accountants practice in the broad field of accounting.

.02 Accounting is a discipline which provides financial and other information essential to the efficient conduct and evaluation of the activities of any organization.

.03 The information which accounting provides is essential for (1) effective planning, control, and decision-making by management, and (2) discharging the accountability of organizations to investors, creditors, government agencies, taxing authorities, association members, contributors to welfare institutions, and others.

.04 Accounting includes the development and analysis of data, the testing of their validity and relevance, and the interpretation and communication of the resulting information to intended users. The data may be expressed in monetary or other quantitative terms, or in symbolic or verbal forms.

.05 Some of the data with which accounting is concerned are not precisely measurable, but necessarily involve assumptions and estimates as to the present effect of future events and other uncertainties. Accordingly, accounting requires not only technical knowledge and skill, but even more importantly, disciplined judgment, perception, and objectivity.

.06 Within this broad field of accounting, certified public accountants are the identified professional accountants. They provide leadership in accounting research and education. In the practice of public accounting CPAs bring competence of professional quality, independence, and a strong concern for the usefulness of the information and advice they provide, but they do not make management decisions.

.07 The professional quality of their services is based upon the requirements for the CPA certificate—education, experience and examination—and upon the ethical and technical standards established and enforced by their profession.

.08 CPAs have a distinctive role in examining financial statements submitted to investors, creditors, and other interested parties, and in expressing independent opinions on the fairness of such statements. This distinctive role has inevitably encouraged a demand for the opinions of CPAs on a wide variety of other representations, such as compliance with rules and regulations of government agencies, sales statistics under lease and royalty agreements, and adherence to covenants in indentures.

.09 The examination of financial statements requires CPAs to review many aspects of an organization's activities and procedures. Consequently they can advise clients of needed improvements in internal control, and make constructive suggestions on financial, tax and other operating matters.

.10 In addition to furnishing advice in conjunction with their independent examinations of financial statements, CPAs are engaged to provide objective advice and consultation on various management problems. Many of these involve information and control systems and techniques, such as budgeting, cost control, profit planning, internal reporting, automatic data processing, and quantitative analysis. CPAs also assist in the development and implementation of programs approved by management.

.11 Among the major management problems depending on the accounting function is compliance with tax requirements. An important part of the practice of CPAs includes tax planning and advice, preparation of tax returns, and representation of clients before government agencies.

.12 CPAs also participate in conferences with government agencies such as the Securities and Exchange Commission, and with other interested parties, such as bankers.

.13 Like other professional men, CPAs are often consulted on business, civic and other problems on which their judgment, experience, and professional standards permit them to provide helpful advice and assistance.

.14 The complexities of an industrial society encourage a high degree of specialization in all professions. The accounting profession is no exception. Its scope is so wide and varied that many individual CPAs choose to specialize in particular types of service.

.15 Although their activities may be diverse, all CPAs have demonstrated basic competence of professional quality in the discipline of accounting. It is this which unites them as members of one profession, and provides a foundation for extension of their services into new areas.

AICPA'S PLAN FOR VOLUNTARY QUALITY CONTROL REVIEW PROGRAM FOR CPA FIRMS WITH SEC PRACTICES OR WITH GENERAL AUDIT PRACTICES

I. *Introduction*

An important part of the profession's system of self-regulation is to see that CPA firms maintain adequate systems of quality control. This is necessary because quality control is a vital element of the profession's assurance to the public that a high level of competence is maintained and that every practicable effort is being made to prevent substandard performance on the part of practitioners.

Toward this end, the American Institute of Certified Public Accountants has established a voluntary program of review of quality control maintained by CPA firms in their audit practices. Standards of quality control have also been promulgated for use in conducting such reviews.

The purpose of the program is educational and preventive in nature and is designed to assist firms in developing and implementing adequate systems of quality control in their audit practices as well as assuring firms with existing systems that their quality control meets, in all material respects, the standards of the profession.

To fulfill its dual purpose, the program includes two types of reviews: consulting reviews and compliance reviews. Consulting reviews are intended to assist firms in developing their systems of quality control and in preparing for participation in the program. Compliance reviews are designed to establish that the quality controls of participating firms meet the standards of the profession.

The program provides direct benefits to the participating firms through the application of objective, outside reviews to their quality control policies and procedures. It is reasonable to expect that these reviews will reduce the number of failures in audit performance that might otherwise occur. However, they cannot provide absolute assurance that all mistakes will be avoided.

The basic elements of the program are described in the balance of this document.

II. *Administration of Program*

The quality control review program, including both consulting reviews and compliance reviews, is administered by a quality control review committee, which establishes policies for implementation of the program. The committee is also responsible for acquainting the business community and general public with the program and the significance of a CPA firm's participation.

As experience is gained, the committee will modify the program to increase its effectiveness. However, the basic features of the plan can be modified only by Council.

The committee is composed of AICPA members in public practice selected to provide a broad representation of the profession. A qualified staff works under the direction of the committee to assist in carrying out the program.

Two subcommittees operate under the direction of the quality

control review committee. One subcommittee is charged with administration of compliance reviews of firms with SEC practices. The other subcommittee administers the consulting reviews and compliance reviews for firms with general audit practices. Some members of the subcommittees are drawn from the quality control review committee.

The possibility exists that a disagreement may arise between a firm and its reviewers. If this occurs and the firm is being reviewed by a review team, the dispute may be submitted to the appropriate subcommittee for resolution. If the firm is being reviewed by another firm, this procedure may be followed with the consent of both firms. If a dispute cannot be resolved by the subcommittee, it will be referred for resolution to an ad hoc review committee appointed by the chairman of the board of the AICPA.

III. Consulting Reviews

1. *General Description.* It is expected that some firms will request assistance in organizing their quality control procedures. To provide that assistance, the following consultation or educational reviews are provided to assist firms in the conduct of their practices or in their preparation for participation in the quality control review program.

   The reviews are conducted on a confidential basis. Except for the quality control document review, no written reports are prepared by the review teams. Neither the Institute nor the reviewed firms will disclose that the reviews have taken place. The reviewed firms pay the reviewers' fees and travel expenses.

2. *Quality Control Document Review.* The Institute provides a service whereby a firm preparing for participation may send a description of its quality control system to the Institute for review and comment. This service is not intended to be a regular prelude to a quality control review or to be an alternative for the preliminary quality control procedures review described below. Rather, it is a means for a firm to obtain advice on the adequacy of its quality control document. If more than a nominal amount of time is required for this service, the firm is charged a fee.

3. *Preliminary Quality Control Procedures Review.* To assist those firms which might want to have others come to their offices to look at their documented procedures and comment on them, a preliminary quality control procedures review program is provided. As is the case with a quality control review, the reviewers make an objective analysis of the documented procedures in the light of the firm's size, organizational structure, and practice philosophies.

   The purpose of the pre-

liminary review is to help a firm prepare for participation in the quality control review program by providing an objective evaluation of the adequacy of its procedures and, if necessary, suggestions for revisions. A review provides a measure of comfort to a firm before it files a letter of intent to participate in the program.

These voluntary reviews are made in the firms' offices on a confidential basis. Since a preliminary review is informal and not complete, it is not a substitute for a full-fledged quality control review.

4. *Technical Standards Review.* This program provides an in-house post-issuance review of working papers and reports for audit engagements and unaudited financial statement engagements. Through this program, firms can arrange for confidential objective reviews of their application of technical standards as indicated by their engagement working papers and reports.

   Checklists for these technical standards reviews which are updated annually may be purchased from the AICPA to assist firms in meeting professional requirements.

IV. General Description of Compliance Reviews

The quality control review program is voluntary and has the following features:

1. The program is open to CPA firms with SEC practices or which have a desire to prepare for such practice and to CPA firms with general audit practices.

2. A quality control review committee composed of members in public practice administers the program.

3. Participation in the program is initiated by a firm's filing a letter of intent with the Institute. The firm states in the letter that it will comply with the provisions of the program and that it will undergo a review of its documented quality control policies and procedures.

4. At the inauguration of the program, some months are needed for firms to arrange for their field reviews. Therefore, responses to inquiries regarding the status of participating firms are to be limited to the statement that they have filed a letter of intent, but that no information about completion of field reviews is to be released by the reviewed firms or the Institute until the end of this interim period.

5. Field reviews are conducted in accordance with standards approved by the auditing standards executive committee. A review is carried out by one of the following methods at the election of the firm to be reviewed:
   a. A review team appointed by the committee.
   b. A CPA firm engaged by

the firm under review.

c. Some other form of independent review satisfactory to the committee, such as an acceptable plan administered by a state society of CPAs.

6. A review includes examination of audit working papers to the extent necessary to determine whether the firm's quality control policies are in compliance with professional standards. The depth of review of working papers for particular engagements is left to the judgment of the reviewers. The review is directed primarily to the key areas of an audit to determine whether in those areas there were well-planned and appropriately executed auditing procedures that were documented in accordance with the firm's policies. If the firm has a significant number of engagements for unaudited financial statements, those engagements are also subject to review.

7. A firm electing to use a committee-appointed review team agrees to provide qualified personnel for the panel from which reviewers for the reviews of other firms are drawn.

8. Upon completion of the review, the review team or reviewing firm prepares a short report stating the results of the review. The report is submitted to the reviewed firm which, at its option, submits the report to the Institute. Such reviews are to be conducted at least once every three years for the firm to continue as a participant.

9. For administrative purposes, the Institute maintains a record of firms filing letters of intent and a record of firms submitting reports on the results of reviews. These records are available to the public upon request.

10. At its option, a firm may advise its clients of having filed a letter of intent and, subsequently, of the results of the review and that the report of the review is on file at the Institute. Results of reviews are not to be released until the end of an interim period to provide time for the completion of reviews of firms participating in the program at its outset.

11. To maintain the program on a self-supporting basis, the following fees are charged to firms:

    a. An annual participation fee based on the number of the firm's professional personnel. A modest fee covers the administrative cost of the program.

    b. Fees for reviews conducted by committee-appointed review teams. These fees are based on the per diem rates for the reviewers and their out-of-pocket expenses. Participating firms electing to be reviewed by other firms make their own fee arrangements.

12. The committee recognizes

that there are differences in the size, structure, and clientele of CPA firms and that quality control procedures will vary according to those characteristics. This program is administered in such a way, however, as to provide a degree of confidence that the participating firms are adhering to applicable professional standards even though they may have varying policies and procedures to achieve such adherence.

13. The program is not intended as a means for taking disciplinary action since it is directed toward reviewing the systems of quality control of firms for their compliance with professional standards rather than the performance of individual professional staff members. It relies on the firms to maintain a continuing surveillance of the performance of their professional staff members. However, in the event serious violations of technical standards are encountered as a byproduct of the program and the reviewed firm does not take appropriate corrective action, the reviewers are not precluded from referring such information to the Institute's professional ethics division. Such reference would be discretionary and any decision in that regard would be made in light of the circumstances.

V. General Procedures for Compliance Reviews

1. *Letter of Intent*. A firm advises the committee of its decision to participate in the program by filing a letter of intent with the following features:

a. Advice as to the method of review selected.

b. The date by which the firm's review will be started and the estimated completion date.

c. A statement that the firm has documented policies and procedures for the quality control of its audit practice.

A firm may terminate its participation in the program at any time. Also, a firm's participation is terminated if it fails to submit a report on the results of its field review within the time period specified under the program and consistent with the standards of the program. After termination, the firm can no longer refer to itself as a participating firm although it may apply at any time to renew its participation.

2. *Quality Control Policies and Procedures*. A firm's quality control policies and procedures affect the quality of work in the firm's audit engagements. While aspects of quality control apply to all firms, the extent to which policies and procedures apply will depend on a variety of factors, such as the size, number of offices, and organizational structure of the firm and its philosophy and practice as to the degree of operating autonomy appropriate for its people. A participating firm is required to make available to the review team or reviewing firm its policies and procedures for quality control.

Attached as Appendix A are examples of policies and procedures for a large firm. Smaller firms might implement their quality control measures by means of policies and procedures such as those suggested in Appendix B. Illustrative sets of appropriate policies and procedures for firms of various sizes are to be made available for the guidance of firms that may wish to utilize them.

In developing its quality control policies and procedures, a firm must be guided by Statement on Auditing Standards No. 4, "Quality Control Considerations for a Firm of Independent Auditors." This Statement suggests the following elements of quality control:

a. *Independence.* Policies and procedures to provide reasonable assurance that persons at all organizational levels maintain independence in fact and in appearance.

b. *Assigning Personnel to Engagements.* Policies and procedures for assigning personnel to engagements to provide reasonable assurance that audit work will be performed by persons having the degree of technical training and proficiency required in the circumstances.

c. *Consultation.* Policies and procedures for consultation to provide reasonable assurance that auditors will seek assistance on accounting and auditing questions, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority.

d. *Supervision.* Policies and procedures for the conduct and supervision of work at all organizational levels to provide reasonable assurance that the work performed meets the firm's standards of quality.

e. *Hiring.* Policies and procedures for hiring to provide reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently.

f. *Professional Development.* Policies and procedures for professional development to provide reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned.

g. *Advancement.* Policies and procedures for advancing professional personnel to provide reasonable assurance that the people selected will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

h. *Acceptance and Continuance of Clients.* Policies and procedures for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity.

i. *Inspection.* Policies and procedures for inspection to provide reasonable assurance that the other procedures designed to maintain the quality of the firm's auditing practice are being effectively

applied.

3. *Field Reviews.* Field reviews are designed to obtain assurance that a firm's quality control policies and procedures conform to professional standards, are adequately documented, and are being complied with. All participating firms are required to undergo a field review at least once every three years to retain their status as participants.

Reviews are conducted at the mutual convenience of the reviewed firm and the reviewers. To accommodate the normal business cycle of the firms, the reviews are conducted during the months of April through December.

Review team members and reviewing firms are expected to have a knowledge of the type of practice of the firm to be reviewed.

It is the responsibility of the review team or reviewing firm to review the quality control policies and procedures to determine that they provide measures reasonable for the particular firm. The firm is advised of apparent deviations, if any, from specified standards. The reviewed firm is given an opportunity to refute or correct such apparent deviations before completion of the review and issuance of the report.

The field reviews are designed, in part, to ascertain that the firm's internal system of quality control is operating as represented. To accomplish this objective, initial attention is directed to a review of documentation in the firm's administrative files, which in the case of multi-office firms is normally located at the executive office. For example, the executive office probably has statistics, correspondence, and other data relative to procedures regarding client acceptance and retention, hiring, training, promotion, independence, and inspection. In addition, the executive office probably has data useful in judging compliance with the firm's policies with respect to supervision and review and consultation.

Client files relating to selected audit engagements, which are normally located in practice offices, are reviewed. The depth of the review of the working papers for particular engagements is decided by the reviewers. The review is directed primarily to the key areas of an audit to determine whether in those areas there were well-planned and appropriately executed auditing procedures that were documented in accordance with the firm's policies.

On occasion, an office of a firm may have legitimate reasons for not permitting the files for a selected engagement to be examined. For example, the financial statements of an engagement may be the subject of litigation or investigation by a government authority or the firm may have been advised by the client that it objects to exposure of the working papers to others, such as the review team. If those making the field review are not satisfied as to the legitimacy of the explanation, the matter is reported to the firm's managing partner.

In the case of a multi-office firm, the degree of centralization of the firm's quality control affects the relative amount of time to be spent

at the executive or practice offices. Practice offices visited are generally representative of the firm's overall audit practice.

Committee-Appointed Review Teams. Review teams appointed by the committee are drawn from the panel of reviewers volunteered by the participating firms. Each team is headed by a team captain who organizes the review according to general guidelines prepared by the committee, supervises the reviewers, and prepares a report on the findings of the review. The firm to be reviewed is advised in advance of the names of the reviewers and their firms.

Participating firms electing to undergo field tests conducted by committee-appointed review teams are required to nominate qualified personnel from their firms for the reviewer panel. Reviews of firms having SEC practices are conducted by audit partners and audit managers knowledgeable about current SEC practice. Reviews of firms with general audit practices are conducted by audit partners and other audit personnel experienced in general audit practice. Managers and other nonpartners are utilized only where subject to the supervision of a partner. A profile is submitted for each nominee indicating the extent of audit experience, SEC experience, participation in his firm's internal quality review programs, present responsibilities, and industry or other special expertise.

The members of a review team are drawn from the reviewer panel. Normally only one partner from a firm is selected for a field test team. In selecting reviewers, consideration is given to their experience with firms and practice units of comparable size and types of practice. Reviewers are required to adhere to all standards applicable to professional engagements, including confidentiality of client relationships. Firms being reviewed by review teams are required to pay the per diem fees of the reviewers and their out-of-pocket travel expenses. The committee sets standard per diem fees for this purpose. The fees are not so large that they might become a reviewer's motive for participating in the program, but reasonably compensate the reviewers' firms for the services of their partners and managers. Reviewers receive fees considerably less than their standard professional fees for services rendered to clients. The team captain receives a slightly higher fee in view of his greater responsibility. These lower fees are justified on the grounds that the program is beneficial not only to the participating firms, but also to the accounting profession as a whole and to the individual reviewers who gain an educational experience from reviewing the procedures of other firms.

The aggregate fee and out-of-pocket travel expenses are paid by the reviewed firm to the Institute for disbursement to the firms of the members of the review team.

A reviewer is not assigned to the review of an executive or practice office in the same geographic area in which he is engaged in public practice. If only one individual is designated by the team captain to visit a practice office, he must be a partner. However, where more

than one team member is involved in a visit to either an executive or practice office, the team members are from different firms and a partner is designated to be in charge of the inspection.

For those reviews conducted by a committee-appointed review team, working papers are retained only until such time as the report on the review has been filed with the Institute or the period for filing the report has elapsed, whichever is earlier.

CPA Firm-Conducted Field Reviews. A participating firm may elect to have the field review of its procedures conducted by another CPA firm instead of by a committee-appointed review team. The reviewing firm follows applicable standards for the conduct of field reviews. In the cases of reviews of firms with SEC practices, the reviewing firm must be knowledgeable about current SEC practice.

The CPA firm conducting the review is independent of the reviewed firm. For example, reciprocal reviews by firms are not permitted.

As in the case with a committee-appointed review team, the reviewing firm is responsible for determining that the quality control policies and procedures provide measures reasonable for the particular firm and that they are being complied with.

4. *Reports on Field Reviews.* Upon completion of the field review, the review team or the reviewing firm reports on the results of the review to the reviewed firm and provides a written short-form report indicating whether or not the firm was complying with the profession's quality control standards.

The reviewed firm, at its option, submits the short-form report to the Institute to maintain the firm's participant status. A copy of the report is maintained in the files of the Institute and is available for public inspection.

Failure to file a report with the Institute within a three-year period causes a firm to be dropped as a participant. Termination of a firm's participation is not publicized.

AICPA'S PROPOSED STATEMENT ON AUDITING STANDARDS THE INDEPENDENT AUDITOR'S RESPONSIBILITY FOR THE DETECTION OF ERRORS OR IRREGULARITIES

(Proposed April 30, 1976)

(Supersedes Statement on Auditing Standards No. 1, section 110.05-.09)

1. This Statement provides guidance on the independent auditor's responsibility for detecting errors or irregularities when making an examination of financial statements in accordance with generally accepted auditing standards.

2. The term *errors* refers to unintentional mistakes in financial statements and includes mathematical or clerical mistakes, mistakes in the application of accounting principles, and oversight or misinterpretation of facts that existed at the time the financial statements were prepared.

3. The term *irregularities* refers to intentional distortions of financial statements, such as deliberate misrepresentations by management, sometimes referred to as management fraud, or misappropriations of assets, sometimes referred to as defalcations.[1] Irregularities in financial statements may result from the misrepresentation or omission of the effects of events or transactions; manipulation, falsification, or alteration of records or documents; omission of significant information from records or documents; recording of transactions without substance; intentional misapplication of accounting principles; or misappropriation of assets for the benefit of management, employees, or third parties. Such acts may be accompanied by the use of false or misleading records or documents and may involve one or more individuals among management, employees, or third parties.

[1] For guidance on other actions that an independent auditor should consider with respect to the possible illegality of such acts, see SAS No. XX, "Illegal Acts By Clients."

Objective of the Auditor's Examination

4. The independent auditor's objective in making an examination of financial statements in accordance with generally accepted auditing standards is to form an opinion as to whether the financial statements present fairly financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles consistently applied. Generally accepted auditing standards require the independent auditor to plan his examination to search for errors or irregularities that would have a material effect on the financial statements and to exercise due skill and care in the conduct of that examination. Generally accepted auditing standards do not require the independent auditor to plan his examination to search for errors or irregularities that would not have a material effect on the financial statements.

Relationship of Independent Audits to Other Business Controls

5. Generally, entities operate with certain controls. Examples of

controls for business entities include legal requirements, the monitoring of management activities by boards of directors and their audit committees, the internal audit function, and internal control procedures. Those who rely on financial statements look to those controls and to independent audits for a degree of assurance that material errors or irregularities will be prevented or, if they occur, detected within a timely period.

6. Independent audits provide reasonable, but not absolute, assurance that financial statements are not materially affected by errors or irregularities. The concept of reasonable assurance recognizes that, as with certain business controls, the costs of audits should bear a reasonable relationship to the benefits expected to be derived. As a result, the concept of testing has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements.

The Auditor's Approach to an Examination

7. The independent auditor's approach when making an examination in accordance with generally accepted auditing standards is influenced by the possibility of errors or irregularities in the circumstances, his judgment concerning the integrity of management, and the relationship between internal control and the potential for errors or irregularities.

8. *Possibility of Errors or Irregularities in the Circumstances.* The auditor should plan and perform an examination of financial statements with an attitude of professional skepticism and should recognize that the application of many of his customary auditing procedures may produce evidence of errors or possible irregularities. For example, the following circumstances, if not reasonably explained, may lead the auditor to question further whether errors or possible irregularities exist: (a) discrepancies within the accounting records, such as a difference between a control account and its supporting subsidiary records; (b) differences disclosed by confirmations; (c) significantly fewer responses to confirmation requests than expected; (d) transactions not supported by proper documentation; (e) transactions not recorded in accordance with management's general or specific authorization; or (f) the completion of large, unusual, or complex transactions at or near year end.

9. Certain acts, such as collusion between client personnel and third parties or among management or employees of the client, may result in misrepresentations' being made to the auditor or in the presentation to the auditor of falsified records or documents that appear truthful and genuine. Examples of corroborative evidential matter that is normally accepted by the auditor are (a) certain representations by management concerning the completeness of the accounting records or the minutes of the board of directors' meetings and (b) documents containing representations from third parties, such as confirmations of accounts receivable by debtors and accounts payable by creditors, and confirmations and other documents received from banks or other depositories. An

auditor cannot practically extend auditing procedures to confirm the truthfulness of all representations and to test the validity of all records or documents that are presented to him during his examination. Consequently, in the absence of evidence raising questions as to the truthfulness of a representation or the validity of a record or document, the auditor's reliance on it is reasonable. Further, auditing procedures cannot detect unrecorded transactions unless the auditor finds some evidence of their existence. An auditor ordinarily would have no means of detecting a failure to record, for example, the receipt of cash from a miscellaneous source or an omission from the accounting records of a payable to a new supplier.

10. *Integrity of Management.* The auditor should recognize that management can direct subordinates to record or conceal transactions in a manner that could result in a material misstatement of the financial statements. Thus, management can perpetrate irregularities by overriding controls that would prevent similar irregularities by other employees. Consequently, the auditor should be aware of the importance of management's integrity to the effective operation of internal control procedures.

11. The extent to which the auditor considers it necessary to corroborate information and representations obtained from management is a matter of judgment. In making that judgment, the auditor should consider whether there are circumstances that might predispose management to misstate financial statements. Such circumstances might include those of a company that is in an industry experiencing a large number of business failures, that lacks sufficient working capital or credit to continue operations, or that is preoccupied with maintaining a favorable earnings trend to the apparent exclusion of business realities.

12. The auditor should consider the possibility that management may have made material misrepresentations or may have overridden control procedures. He should evaluate these risks by considering factors such as the nature of the entity being audited, the susceptibility to irregularities of the item or transaction being examined, the degree of authority vested at various management levels, and prior experience with the client. For example, the following circumstances relating to the structure of a client's organization, although not necessarily indicative of the presence of irregularities, may cause the auditor to be concerned about the possibility that management may have made material misrepresentations or overridden internal control procedures: (a) operating management appears to have little regard for the need to establish and follow internal control procedures; (b) the company needs, but lacks, an internal audit staff; (c) key financial positions, such as controller, have a high turnover rate; or (d) the accounting and financial functions appear to be understaffed, resulting in a constant crisis condition and related loss of controls. However, obtaining more than reasonable satisfaction that management has not made material misrepresentations or has not overridden control procedures is not possible.

13. *Relationship Between Internal Control and the Potential for Errors or Irregularities.* Management is responsible for establishing

and maintaining internal control procedures, including appropriate supervisory review procedures to encourage adherence to adopted policies and prescribed procedures and to identify errors and irregularities. This responsibility requires an awareness of the various types of errors and irregularities that may arise in the company's financial and reporting system and of the possible effects of such errors or irregularities on the financial statements.

14. Providing reasonable assurance that errors and irregularities in financial statements will be prevented or detected within a timely period is a function of internal control. SAS No. 1, section 320.65–.66, suggests the following approach to the auditor's evaluation of that function:

> A conceptually logical approach to the auditor's evaluation of accounting control, which focuses directly on the purpose of preventing or detecting material errors and irregularities in financial statements, is to apply the following steps in considering each significant class of transactions and related assets involved in the audit:
>
> a. Consider the types of errors and irregularities that could occur.
> b. Determine the accounting control procedures that should prevent or detect such errors and irregularities.
> c. Determine whether the necessary procedures are prescribed and are being followed satisfactorily.
> d. Evaluate any weaknesses—i.e., types of potential errors and irregularities not covered by existing control procedures—to determine their effect on (1) the nature, timing, or extent of auditing procedures to be applied and (2) suggestions to be made to the client.
>
> In the practical application of the foregoing approach, the first two steps are performed primarily through the development of questionnaires, checklists, instructions, or similar generalized material used by the auditor. However, professional judgment is required in interpreting, adapting, or expanding such generalized material as appropriate in particular situations. The third step is accomplished through the review of the system and tests of compliance and the final step through the exercise of professional judgment in evaluating the information obtained in the preceding steps.

In the development of questionnaires and checklists, the auditor uses accumulated experience and understanding of the points of risk for probable errors and irregularities. Irregularities commonly involve manipulation of particular aspects of the financial operations of a company or at certain times—for example, unusual entries in the cash account at or near a balance sheet date that affect the amount of cash presented.

15. Effective internal control reduces the probability that errors or irregularities will occur, but does not eliminate the possibility that they can occur. There are inherent limitations that should be recognized in considering the potential effectiveness of internal accounting control procedures (see SAS No. 1, section 320.34). Further, whether the objectives of accounting control will be achieved depends in substantial part on the competence and integrity of company personnel (see SAS No. 1, section 320.35). Consequently, the auditor does not place complete

reliance on internal control. SAS No. 1, section 320.71, states in part:

> The second standard [of field work] does not contemplate that the auditor will place complete reliance on internal control to the exclusion of other auditing procedures with respect to material amounts in the financial statements.

Thus, the auditor's examination normally includes procedures to test for the existence of errors or irregularities that could occur and have a material effect on the financial statements even in the absence of material weaknesses[2] in internal control.

Procedures When Circumstances Indicate Possible Errors or Irregularities

16. If the independent auditor's examination reveals circumstances that cause him to believe that material errors or irregularities may exist, he should consider their implications and discuss the matter and the extent of any further investigation with appropriate levels of management, including, when advisable in his judgment, the board of directors or its audit committee. If senior members of management appear to be involved in irregularities, the board of directors or its audit committee should be informed. Also, if the auditor believes that material errors or irregularities may exist, he should attempt to obtain sufficient evidential matter to determine whether in fact they may have occurred and, if so, their effect. In this regard, the auditor may wish to consult with legal counsel on matters concerning questions of law. If practicable, the auditor should extend the scope of his examination in an effort to obtain such evidential matter. In some circumstances, however, it may be impracticable or impossible to obtain sufficient evidential matter to determine the possible existence of, or related effect of, material errors or irregularities, or the client may impose a limitation on the scope of the auditor's search for the evidential matter needed to reach a conclusion. If for any reason the auditor remains uncertain as to whether there are errors or irregularities that may materially affect the financial statements, he should consider qualifying his opinion or disclaiming an opinion on the financial statement or, depending on the circumstances, withdrawing from the engagement, indicating his reasons and findings in writing to the board of directors.

17. The independent auditor's examination may reveal possible errors or irregularities that he concludes could not be so material as to affect the financial statements he is examining. For example, irregularities involving peculations from a small imprest fund would normally be of little significance because both the manner of operating the fund and its size would tend to establish a limitation on the amount of a loss. The auditor should refer such mat-

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[2] SAS No. 1, section 320.68, defines a material weakness as follows:

> . . . a condition in which the auditor believes the prescribed procedures or the degree of compliance with them does not provide reasonable assurance that errors or irregularities in amounts that would be material in the financial statements being audited would be prevented or detected within a timely period by employees in the normal course of performing their assigned functions.

ters to a representative of the client who appears to be at least one level above those involved, with the recommendation that the matter be pursued to a conclusion. The auditor should consider the effect of any immaterial irregularities, and the personnel involved, as it may relate to other aspects of his examination.

The Auditor's Responsibility to Detect Errors or Irregularities

18. An independent auditor's standard report expresses his opinion that the financial statements are presented fairly in conformity with generally accepted accounting principles, and implicitly indicates that, in his judgment, the statements taken as a whole are not materially misstated as a result of errors or irregularities. In reaching that judgment, the auditor's responsibility is to exercise due skill and care in the planning and conduct of his examination. However, identifying irregularities resulting from collusion, forgery, or certain unrecorded transactions ordinarily is not practicable for the auditor. Reasonable reliance on the client's accounting records ordinarily is warranted and unavoidable. Also, the auditor's resources for obtaining information, and his authority for that purpose, are significantly less than those of a law enforcement or regulatory agency conducting an investigation. In view of those and other limitations on the effectiveness of auditing procedures, an audit cannot be expected to provide absolute assurance that the financial statements are not materially affected by errors or irregularities. Thus, the subsequent discovery that errors or irregularities existed during the period covered by the independent auditor's examination does not, in itself, indicate inadequate performance on his part. If the auditor's examination was made in accordance with generally accepted auditing standards, he has fulfilled his professional responsibility.

AICPA'S PROPOSED STATEMENT ON AUDITING STANDARDS ILLEGAL ACTS BY CLIENTS

(Proposed April 30, 1976)

1. This Statement provides guidance for an independent auditor when acts that appear to him to be illegal come to his attention during an examination of financial statements in accordance with generally accepted auditing standards. This Statement also discusses the extent of the attention he should give, when performing such an examination, to the possibility that such acts may have occurred. The types of acts encompassed by this Statement include illegal political contributions to a candidate in an election for a federal office, bribes, and other violations of laws and regulations.

2. This Statement sets forth guidelines for the appropriate conduct of an independent auditor in fulfilling his obligation to report on financial statements in accordance with professional standards (paragraphs 4-19). It also offers practical suggestions and guidance for the auditor in connection with illegal acts not having a material effect on the financial statements (paragraphs 20 and 21).

3. An examination made in accordance with generally accepted auditing standards cannot be expected to provide assurance that illegal acts will be detected.[1] In reporting on financial statements, the independent auditor holds himself out as one who is proficient in accounting and auditing. Determining whether an act is illegal is usually beyond the professional competence of an auditor. The auditor's training and experience, however, ordinarily should provide a reasonable basis for an awareness that some acts by a client coming to his attention in the performance of his examination might be illegal. Nevertheless, the further removed such an act is from the events and transactions ordinarily reflected specifically in financial statements, the less likely it is that the auditor may become aware of the act or recognize its possible illegality.

Procedures That May Identify Illegal Acts

4. The auditor's examination in accordance with generally accepted auditing standards does not ordinarily include procedures specifically designed to detect illegal acts. In making such an examination, however, the auditor should be aware of the possibility that illegal acts may have occurred that may have a material effect on the financial statements. If as a result of his procedures the auditor believes that illegal acts may have occurred, he should perform additional procedures to investigate those matters, including consultation with legal counsel as necessary, to obtain an understanding of the nature of the acts and their possible effects on the financial statements.

5. The auditor's examination contains procedures that are per-

[1] See SAS No. XX, "The Independent Auditor's Responsibility for the Detection of Errors and Irregularities," paragraph 18, regarding the limitations of an examination in accordance with generally accepted auditing standards.

formed primarily for other purposes, but that may also bring possible illegal acts to his attention. Such procedures include evaluation of internal control and related tests of transactions and balances (paragraphs 6-8), and inquiries of management and others (paragraphs 9 and 10).

6. *Evaluation of Internal Control and Related Tests of Transactions and Balances.* The auditor's interest in internal accounting control relates to the authorization, execution, and recording of transactions and accountability for the related assets (see SAS No. 1, sections 320.27-.40 and 320.43-.48). The auditor's review and tests of compliance with internal accounting control procedures and related substantive tests may bring to his attention unauthorized transactions; transactions improperly recorded as to amount, accounting period, or classification; or transactions not recorded in a complete or timely manner to maintain accountability for assets. Such transactions may raise questions about the possible existence of an illegal act.

7. In making an examination, the auditor obtains evidential matter as to the propriety of the accounting treatment of and support for transactions and balances. The procedures performed to obtain evidential matter include obtaining an understanding of the transactions tested and their business purpose. A transaction that appears to the auditor to have a very unusual or questionable purpose may raise questions about the possible existence of an illegal act.

8. In making an examination, the auditor ordinarily considers laws and regulations that have a direct monetary effect on the amounts presented in financial statements, knowledge of which is within the expertise of the auditor. For example, tax laws affect accruals and the amount recognized as an expense in the accounting period. Also, applicable laws or regulations may affect the amount of revenue accrued under government contracts.

9. *Inquiries of Management and Others.* The auditor's examination should include inquiries of the client's management in connection with the accounting for, and disclosure of, loss contingencies and related communication with legal counsel. The auditor should also inquire about the client's compliance with laws and regulations and about the client's procedures relevant to the prevention or detection of illegal acts, such as policy directives issued by the client and periodic representations obtained by the client from management at appropriate levels of authority concerning compliance with laws and regulations. Possible illegal acts may come to the auditor's attention through such inquiries. For example, an auditor may learn of an investigation by a governmental agency or enforcement proceedings concerning violations of laws with respect to occupational health and safety, food and drug administration, securities, truth in lending, environmental protection, or price fixing or other anti-trust practices.

10. If no external evidence, such as a government agency investigation or an enforcement proceeding, comes to the auditor's attention or if there is no information from the client's management or legal

counsel drawing his attention to such matters, the auditor's examination cannot reasonably be expected to detect the types of violations of laws and regulations that are indicated in paragraph 9. The laws and regulations governing hose matters are highly specialized and complex. Also, they normally relate to the operating aspects of an entity rather than its financial or accounting aspects. Consequently, determining compliance with such laws and regulations is outside the professional competence of independent auditors.

Evaluation of the Materiality of an Illegal Act

11. In evaluating the materiality of an illegal act coming to his attention, the auditor should consider the monetary effects, if any, on the financial statements of the transactions involved, including the related contingent monetary effects of the violation. Contingent monetary effects include fines, penalties, and damages. Other effects of a violation that also should be considered include loss contingencies that should be disclosed and other matters that should be disclosed in the financial statements (see paragraphs 13 and 14).

12. Loss contingencies, such as the threat of expropriation of assets, enforced discontinuance of operations in a foreign country, or possible litigation, may arise as a result of an illegal act. The auditor's considerations for evaluating the materiality of those loss contingencies are similar to those applicable to other loss contingencies.[2]

13. The auditor should also evaluate the adequacy of disclosure of the potential effect of an illegal act on the operations of the entity. If a significant amount of revenue or earnings is derived from transactions involving illegal acts, or if illegal acts create significant unusual risks associated with a material amount of revenue or earnings, such as the loss of a significant business relationship, that information ordinarily should be considered for disclosure in the financial statements.

14. In the case of certain illegal acts not having a material effect on the financial statements, there nevertheless may exist a material loss contingency requiring disclosure in the financial statements because of management's failure to make a required nonfinancial-statement disclosure. For example, nonfinancial-statement disclosure of certain illegal acts by management, such as conviction for illegal campaign contributions, may be necessary to comply with the requirements of a regulatory agency because of their alleged impact on the integrity of management, even though the amounts are not material to the financial statements.[3] Determining whether the client is required by applicable laws and regulations to make such disclosure ordinarily requires an opinion from legal counsel.

[2] Generally accepted accounting principles for the financial accounting for and reporting of loss contingencies are contained in Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies."

[3] For example, the SEC's Securities Act Release No. 5466 requires that ". . . the conviction of a corporation and/or its officers or directors for having made illegal campaign contributions . . . should be disclosed to the public and specifically to the shareholders, particularly in the context of a proxy statement where shareholders are being asked to vote for management."

Actions by the Auditor Concerning a Possible Illegal Act

15. Because of the variety of acts and circumstances that might be encountered, it is not practicable to provide specific guidance on the steps an auditor should consider taking with respect to a possible illegal act that comes to his attention. The auditor should consider the circumstances promptly; such consideration may include seeking the advice of legal counsel or other specialists. The implications of a possible illegal act should be considered in relation to the intended degree of reliance to be placed on the internal accounting control and the representations of management.

16. After it has been determined that an illegal act has occurred, the auditor should report the circumstances to personnel in the client's organization at a high enough level of authority so that appropriate action can be taken with respect to—

(a) adjustments or disclosures that may be necessary in the financial statements;
(b) disclosures that may be required in other documents issued on a more timely basis; and
(c) consideration of appropriate remedial actions to be taken.

In some circumstances, the only appropriate persons of a sufficiently high level of authority to take necessary action in the organization may be the audit committee or the board of directors.

Illegal Acts Having a Material Effect

17. If the auditor concludes that an event whose effect, taken alone or with similar events, is material in amount and has not been properly accounted for or disclosed in the financial statements, he would ordinarily need to qualify his opinion or express an adverse opinion because of the departure from generally accepted accounting principles (see SAS No. 2, paragraphs 15-17).

18. The auditor may conclude that the effects of an illegal act on the financial statements are not susceptible of reasonable estimation. When it is reasonably possible, or probable, that a loss contingency arising from an illegal act will be resolved by a future event and the amount of the potential loss cannot be estimated, an uncertainty exists for which the auditor should consider the need to qualify his opinion (see SAS No. 2, paragraphs 21-25).

19. In some instances, the auditor may not be able to determine the amounts associated with an event, taken alone or with similar events, because of an inability to obtain sufficient competent evidential matter. For example, the act may have been accomplished by circumventing the internal control system and may not be properly recorded or otherwise adequately documented. In those circumstances, the auditor should consider the need to qualify his opinion or disclaim an opinion because of the scope limitation (see SAS No. 2, paragraphs 10-12).

Consideration of Other Illegal Acts

20. The auditor's consideration of illegal acts that come to his attention that do not have a material effect on the financial statements will normally be influenced by the nature of the act and management's actions once the matter is brought

to its attention. If an illegal act has come to his attention and he cannot persuade the client's board of directors or its audit committee or other appropriate levels within the organization to give appropriate consideration to remedial action, the auditor should consider withdrawing from the current engagement or dissociating himself from any future relationship with the client. The auditor's decision as to whether to withdraw or dissociate because of an illegal act not having a material effect on the financial statements ordinarily will be affected by the following factors: (a) the effects on his ability to rely on management's representations and (b) the possible effects of continuing his association with the client, including the appearance of a loss of independence. In reaching a decision on withdrawal or dissociation, the auditor should consult with legal counsel.

Notification of Outside Parties

21. Deciding whether there is a need to notify outside parties of an illegal act is the responsibility of management. In the ordinary case, the auditor is under no legal obligation to notify outside parties. However, if the auditor considers the illegal act to be sufficiently serious to warrant withdrawing from the engagement, he should consult his legal counsel as to what other action, if any, he should take.

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DEFINING THE ROLE AND RESPONSIBILITIES OF INDEPENDENT AUDITORS

A PROGRESS REPORT TO COUNCIL

Manuel F. Cohen, Chairman
Commission on Auditors' Responsibilities
May 1976

We are here to report on the progress of the work of the Commission on Auditors' Responsibilities, to discuss some of the problems we have encountered, to expose our thinking on some critical issues, and to seek feedback that will help us in our work. It is now almost eighteen months since we undertook our study. I am sure that you are concerned that we complete our work as expeditiously as possible. However, we are in the middle of an enormous and complex assignment. We have spent about forty-two days in meetings of the full Commission and many more hours in preparation. Our goal is to define the role and responsibilities of independent auditors and to recommend carefully developed standards by which their performance should be evaluated.

I must remind you at the outset that we are not a standard-setting body. Our conclusions and recommendations will not be issued as authoritative pronouncements. Their authority will rest on their persuasiveness. An integral part of our work is to persuade other bodies to adopt and implement our recommendations.

We have made significant progress in our study. The forty-page Statement of Issues, which we published last fall, indicates the scope of our study. Briefly summarize, the total project consists of three fundamental elements. The first is a group of studies intended to develop an appropriate and workable concept of responsibility in a number of critical areas, such as uncertainty, fraud, illegal acts of management and communication of the results of the examination including forming an opinion on financial statements—the "present fairly" issue.

A second element involves consideration of the current role of the auditor as it may be affected by the rendering of other services, such as MAS and tax, and how that role might be affected by extension to new areas, such as forecasts.

However, no statement of auditors' responsibilities would be useful unless its fulfillment was within the capacity of the auditor and unless it was consistent with the reasonable expectations of users. Therefore, the third element of our study is a comparison of the "resource inventory" of the auditor—his

education, development of auditing standards and procedures, the professional climate and regulatory structure within which he works—with a reasonable conception of his responsibilities in the areas suggested earlier.

In addressing those issues, we have been probing questions as fundamental as:

- What function do independent auditors perform when they express opinions on financial statements?
- How closely is the auditor's function tied to the financial information with which he is associated? For example, does an annual audit involve a responsibility limited to the financial statements or is there some continuous responsibility not limited to particular financial statements?
- To what extent does the auditor have a whistle-blowing obligation?
- Should the auditing profession be viewed as a single, unitary one or a tiered profession with two or more layers that involve different types of practice?

Another fundamental question relates to the procedural direction we are following. Are we devoting too much time to issues that the Institute's auditing standards executive committee or the Securities and Exchange Commission is currently considering? We think not. Our perspective is different from that of the auditing standards committee or the SEC. We are considering all of the issues in a broad integrated framework. Our objective is to articulate a coherent, consistent, and useful position on the sensitive issues that shape the concept and understanding of the role and responsibilities of independent auditors.

These then are some of the fundamental questions that we are considering. Each has implications that cut across the other issues we are studying.

Let me review where we stand today on some of those issues. I emphasize that these "stands" are tentative positions that will continue to evolve as we receive both more evidence from our own research and more feedback from individuals and groups such as the Council. Thus, I urge you to use the simultaneous sessions that follow to comment on the specific points I will make in the next few minutes.

We recognize that our conclusions on each issue must be consistent with a realistic conception of the independent auditor's role in society. Basic to our study is the conclusion, which we can all accept, that the essential role of the independent

auditor and the need for the function he performs lie in the contribution that he makes and can make to the credibility of financial information. Credible financial information issued by business enterprises is essential to the public's overall confidence in financial markets. Consequently we have not limited our study to formal financial statements. We believe that a broader examination of the auditor's role with respect to financial information beyond financial statements is necessary for a reasonable evaluation of demands for and possible extensions of the auditor's traditional role.

On a more specific issue, we are attempting to resolve the persistent confusion that has surrounded the use of the term "present fairly." The result of that work—at least to date—is in the paper "Forming an Opinion on Financial Presentations," that was distributed to you before this meeting. This paper, tentative though it is, "fairly presents" the direction of the thinking of the Commission at this point, the level at which we are examining the issues, and the type of conclusions being developed.

Widespread misunderstanding of the term "present fairly" has contributed to the expectation gap confronting auditors. Judge MacMahon's observation in the Herzfeld case that the courts are appropriately concerned with "whether the report

fairly presents the true financial position...to the untutored eye of an ordinary investor," is evidence of the confusion. Judge MacMahon's view seems far too narrow; we know there is no "true" financial position. However, in addressing the issue, we have not continued the debate about what "present fairly" means to all who read that phrase. Instead, we have attempted to state more precisely the nature of the judgments and decisions required in forming an opinion on financial statements. A better understanding of the role of judgment in the application of generally accepted accounting principles and a strengthening of generally accepted auditing standards to provide independent auditors with improved guides to apply judgment should eliminate much of the debate and confusion. We would impose greater and more explicit responsibility on the auditor for judging the appropriateness of the accounting principles selected and provide him with more explicit guidance for making that evaluation. We would require auditors to stand back and evaluate the appropriateness of the overall effect of the accounting principles selected and the overall effect of the individual decisions made.

We are taking great care to convey the message that the financial statements are the representations of management. Our position on reporting when a company faces unusual uncertainties reinforces that message. We have tentatively concluded that the financial statements and related disclosure should bear the burden

of highlighting unusual uncertainties and that the "subject to" opinion should be eliminated. A strategically placed note to the financial statements describing the uncertainty and disclosing the possible material adverse effect of an unfavorable outcome would be far more desirable than the often misunderstood and usually redundant "subject to" opinion. It seems to us that management should assume a greater affirmative obligation of analysis and interpretation of the financial statements and related disclosures.

In another area, we are attempting to clarify the auditor's responsibility for the detection of management fraud. In an audit of financial statements, an independent auditor is concerned with the adequacy of controls and measures designed to prevent fraud. He has an affirmative duty to look for fraud. However he should not always be held liable for failure to find it. Instead, his performance ought to be evaluated on the basis of the extent to which he exercises professional skill and care commensurate with a reasonable estimate of the costs and benefits of the audit function. The exercise of professional skill and care is the touchstone. The elements that constitute the exercise of professional skill and care ought to be identified and adopted as a part of auditing standards. We are attempting to identify the substance of those elements.

We have wrestled with two issues without yet developing a consensus. The first concerns the auditor's responsibility for the detection and disclosure of illegal and improper acts of management. That issue is perhaps the hottest topic around today if not necessarily the most important in the long run. In January, Senator William Proxmire, Chairman of the Joint Congressional Subcommittee on Priorities and Economy in Government, in an exchange with SEC Chairman Roderick Hills, seemed to imply that the auditor should have the responsibility not only for disclosing such payments but also of uncovering them. Of course, we recognize that the independent auditor's responsibility for illegal payments that have a material effect on the financial statements is the same as his responsibility for the detection of management fraud. His performance should be governed by the standard of professional skill and care appropriate to fraud. Beyond that, the issue becomes very murky indeed. One thing seems clear to us: The responsibility for disclosing known illegal or improper acts should be considered separately from responsibility that the independent auditor may have for detecting such behavior. The two types of responsibility are different.

I have been closely involved as legal counsel in several of the leading cases in this area. I know how delicate and sensitive the question of the indepenent auditor's responsibility

is. There are few guidelines. Confusing signals appear to emanate from the Securities and Exchange Commission. Some guidelines have been promised by the SEC. However, until useful guidelines are developed, the best that we can hope to do is to lay out some possible alternatives for defining the auditor's responsibility consistent with our conception of his role. At this stage, we can see no clear-cut solution. The questions are perplexing. What role should materiality play? How should it be defined? To whom should a disclosure responsibility run? What would be the impact on the auditor-client relationship?

The stakes are high. We cannot simply wait for the regulatory bodies to set guidelines and meekly fall into line. We must speak forcefully to this issue and help to shape the evolving role of the independent auditor in this area from a perspective broader than merely the currently fashionable concern for illegal campaign contributions and foreign bribes.

The second issue with which we are still struggling concerns the communication actually provided in auditor's reports. Evidence abounds that the standard report is misunderstood. Recent surveys indicate that many investors do not bother to read the auditor's report and that those who do read it do not understand the premises on which it is based and the nature of the conclusions intended to be conveyed. More disturbing is the

evidence from these surveys and other sources that many investors view the report as a "Good Housekeeping Seal of Approval."

We have concluded that ways must be found to communicate better to those who rely on the work of independent auditors. We are considering alternative ways of doing this that are not limited to small revisions in the language in the auditor's report. We have reached a consensus to recommend that a report by the chief financial officer be included with the auditor's report to reinforce the message that the financial statements are the representations of management and to explain more precisely the role of the independent auditor in their presentation. Moreover, we are looking at the issue of communication not merely in terms of the traditional standard report but also in terms of other possible reports on other financial information. We plan to expose our views on possible alternatives and to consider the feedback from the public hearings.

I cannot emphasize too strongly that we are not compartmentalizing issues. Our conclusions on each issue must be tested against our conclusions on other issues.

We have a broad range of interrelated issues and are conducting research to develop evidence that will be useful in our deliberations on those issues. Indeed, our research effort is the core of our study.

Three of our research projects are designed to help us identify problem areas in practice and to determine what can be done. The first in this category is a broad survey and analysis of legal and other cases involving alleged audit failures. This is basic to the entire project and involves the largest manpower commitment. The staff is compiling a data bank of significant cases in the last ten years.

The second project in this category is a questionnaire survey of staff auditors or former staff auditors with the sample selected from the membership of the Institute. The survey is designed to study the effects of selected aspects of auditors' work environment, such as time-budget pressures, on their behavior and performance.

The third project in this category consists of interviews of technical partners and legal counsels of audit firms by members of the Commission and senior members of the Commission's staff. The interviews are arranged to allow those on the firing line to discuss with us in confidence some of the problems they have encountered in their experience.

In other areas, we are involved with two questionnaire surveys. The first queries analysts and investors on the significance to them of disclosures in financial statements of information on illegal and other improper acts of management.

It focuses on acts whose effects are not material in traditional financial statement terms. The purpose is to determine whether analysts and investors consider information of that type for their investment decisions.

The second survey, conducted by researchers at the University of Illinois, concerns communication in the auditor's standard report. We hope to obtain from the study more information on users' understanding of the auditor's standard report in its present form.

In another area of our concern, we are sponsoring a symposium on the implications for auditing of the growing body of literature and empirical evidence that seems to suggest that the present scheme of financial reporting has very little impact on the functioning of capital markets. Several leading authorities have been invited to discuss the problem for our benefit.

We are ever mindful of the need to consider the incremental costs and benefits of any changes that we may recommend. For that reason, we have commissioned a study to develop a conceptual model for analyzing the cost-benefit relationships of the audit function.

In addition, our staff and consultants have prepared background papers on all of the issues on which we are reaching

some tentative conclusions. Several additional background papers are in preparation. They include papers on:

1. New forms of reporting.
2. Regulation of the auditing profession.
3. Education and training of auditors.
4. The relationship between the auditor and parties interested in the audit function.
5. The auditor's legal environment.

It would serve no purpose here to repeat the issues in our Statement of Issues. You are aware that they run the gamut of problems significant to independent auditors. We are considering the whole broad structure by which independent auditors are trained, regulated, and disciplined. We are looking at the structure of the profession from the broadest possible perspective. We are not ignoring the problems of any segment of the profession. In probing the question of whether or not more explicit recognition should be given to the multi-tiered character of the profession, we are giving special attention to the problems of sole practitioners and CPA firms with several rather than hundreds of partners.

As might be expected with a project of this complexity, there has been a considerable start-up period. Lee Seidler, now serving as deputy chairman of the Commission, has assumed principal

responsibility for policy implementation and day-to-day direction of Commission activities. Doug Carmichael, who recently became the managing director of the technical divisions of the Institute, devotes virtually full time to directing the Commission's staff.

Each member of the Commission works closely with assigned staff on specific projects.

As we completed the clarification of the issues facing the Commission, it became clear that the amount of skilled, experienced manpower resources necessary for the effective completion of our task would be far greater than was originally contemplated. In response to this need, I am pleased to note that four firms—Arthur Andersen, Arthur Young, Coopers & Lybrand and Peat, Marwick—have provided four highly competent and experienced people to serve full time with the Commission for an extended period of time. With these resources, in addition to the able members of the AICPA staff, I believe that we will move towards a rapid, but thorough completion of our assigned responsibility.

Where do we go from here? As you've seen, we are moving towards tentative conclusions on many of the issues. We expect to publish soon the first of a series of discussion documents and schedule public hearings. After the public hearings have been conducted and all of the evidence is in, we will proceed to complete our deliberations and prepare our final report.

From you, we ask interest, cooperation, evaluation and frank criticism. There will be a member of the Commission and its staff in each of the concurrent sessions. You have had a chance to read one of our tentative papers and to hear me speak. Now, I urge you to speak to us in the concurrent sessions that follow.

Manuel F. Cohen, Chairman
Commission on Auditors' Responsibilities
May 1976

Accounting Research Association
American Institute of
Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036

An appeal to all public accounting firms and individual practitioners represented in the American Institute

Dear Member:

The Financial Accounting Standards Board has been making progress in its efforts to solve current problems in accounting and financial reporting practice. The Board has been examining a wide range of critically important questions and it has already issued a number of major pronouncements.

Obviously, the type of independent, full-scale research activities that the FASB is currently engaged in requires a great deal of money. This money is now being provided by all of the professional organizations that have a stake in the Board's success.

As its share, the American Institute has agreed to contribute two million dollars a year for five years. Since a substantial part of this must come from voluntary membership in the Accounting Research Association, I urge you to consider membership in the Accounting Research Association more seriously than ever before.

* * *

You may also want to consider associate membership in the Financial Accounting Foundation — a new service that is now available to ARA members.

The Trustees of the FAF have recently adopted a plan whereby contributors to the Accounting Research Association may become associate members of the Foundation. This associate membership offers public accounting firms the benefit of receiving — via first class mail — two gratis copies of the following FASB publications, plus a twenty percent discount on any additional copies ordered.

Status Report (the FASB monthly newsletter)

Statements of the FASB

Interpretations of the FASB

Exposure Drafts and Discussion Memoranda

Public accounting firms that annually contribute at least $200 to the ARA will automatically become associate members of FAF at no additional cost. Firms whose current dues are less than this amount may become FAF associate

members by increasing their annual contributions to the ARA to a total of $200.

Individuals may become FAF associate members by increasing their annual contributions to the ARA to a total of $100. Individual members will receive one gratis copy of each of the FASB materials listed.

If you would like to take advantage of this opportunity to receive FASB publications through FAF associate membership, please return the additional form with your ARA membership application. We will arrange for the Financial Accounting Foundation to record your associate membership as quickly as possible after receipt of your payment.

Even if you choose not to apply for FAF associate membership, I sincerely hope you will decide to support the Accounting Research Association. ARA membership represents an investment in an enterprise that is having a major impact on our profession's future and thus on the future of each and every one of us. We should all, therefore, feel some responsibility for contributing to its success.

Sincerely,

Michael N. Chetkovich

Michael N. Chetkovich, CPA
Chairman, Board of Trustees

MNC:jg

P.S. I am sure I do not need to remind you that your dues covering both ARA membership and FAF associate membership are tax deductible.

An invitation for you to help your profession support the development of improved financial reporting techniques and accounting standards.

ACCOUNTING RESEARCH ASSOCIATION OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

The introduction of innovative business techniques and a growing demand on the part of bankers, financial analysts and the investing public for more informative financial reports have given rise to new and extremely difficult problems for the accounting profession.

These problems have in turn intensified the need to improve financial reporting techniques and, wherever possible, to narrow or eliminate the areas of difference or inconsistency that may exist in current accounting practice.

The new, independent approach to accounting standards requires substantial support.

Responsibility for setting accounting standards now rests with the Financial Accounting Standards Board. Establishment of this independent Board represents the most promising effort made by the profession to establish a comprehensive body of standards.

The program and activities of the FASB and its supporting staff are extensive and continually expanding. And the funds needed to support these activities are considerable.

The program has vitally important implications for every CPA firm and every individual CPA.

This intensified and accelerated approach to the establishment of accounting standards is of major practical significance to every CPA firm and every individual CPA. The broad-scale independent study and research now being conducted by the Financial Accounting Standards Board . . and the improvements in financial reporting that are resulting from that research . . represent a forceful and affirmative response to the criticisms that have been directed at the accounting profession. The success of the program is therefore certain to contribute to your own success, professional well-being and prestige.

Support of this independent approach to accounting standards must be broad-based in order to be most successful.

This type of independent development and refinement of accounting standards can only be effective if it has the support of *all* the accounting, business, financial and educational communities that have a vital interest and stake in its success.

Support of the Financial Accounting Standards Board is therefore now being provided jointly by *all* of the major professional organizations concerned —

AMERICAN ACCOUNTING ASSOCIATION

FINANCIAL ANALYSTS FEDERATION

FINANCIAL EXECUTIVES INSTITUTE

NATIONAL ASSOCIATION OF ACCOUNTANTS

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

The AICPA is committed to provide a substantial part of this support.

As its share of the support that must be provided for the Financial Accounting Standards Board, the American Institute has made a commitment to provide $2,000,000 a year for five years toward the FASB's independent research program

The *Accounting Research Association* is the vehicle through which the AICPA is helping to provide this share of financial support. A substantial part of the $2,000,000 commitment must therefore come from voluntary membership in the *Association*

Two types of membership are available ... based on your stake in the program.

FIRM MEMBERSHIP. Any firm of certified public accountants having at least one partner who is a member of the AICPA is eligible for firm membership in the *Accounting Research Association.*

It is assumed that a firm's stake in the establishment of financial accounting standards is generally proportionate to the size of the firm. As indicated in the schedule on the right, membership dues for a firm are therefore scaled in proportion to the number of partners and professional people on its staff. (Secretaries, typists, machine operators and similar employees are considered to be non-professional and are excluded from this dues base.) For administrative convenience, a bracket system is used for each firm membership.

INDIVIDUAL MEMBERSHIP. Any CPA who is a member or an associate of the American Institute but *who does not employ a professional accounting staff* is eligible for individual membership in the *Association* at the minimum dues rate.

For staff members who may want to add their personal support to the ARA, individual membership is also open to partners or professional employees of firms that are members of the *Accounting Research Association.*

Will you do your share to help support this essential activity?

Thousands of individual CPAs in industry, government, education and public practice and thousands of public accounting firms of all sizes are now doing their share through membership in the *Accounting Research Association.* But there are still many thousands more who have not yet come forward with their support. (Needless to say, your support — in the form of dues to the *Accounting Research Association* — is tax deductible.)

If you are not already a member of the *Association,* we urge you to join today. You will become part of an impressive body of firms and individuals who have responded in a positive way to help your profession meet its most critical challenge.

ACCOUNTING RESEARCH ASSOCIATION
OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Dues Schedule

FIRM MEMBERSHIP

Total Partners and Professional Staff*	Annual Dues**
1-3	$25.
4-6	$75.
7-9	$120
10-19	$225
20-39	$450.
40-59	$1,000.
60-99	$1,600
100-199	$3,750.
200-299	$6,250.
300-499	$12,000.
500-899	$21,000.
900-1,299	$33,000.
1,300-1,699	$52,500.
1,700 and over	$200,000

INDIVIDUAL MEMBERSHIP

Sole Practitioner (No Professional Staff—$25.

Individual not in public practice—$25.

Partner or professional employee in an ARA member firm—$25.

* As of November 1st preceding the membership year.

** Membership year corresponds to the calendar year. Dues for new members will be prorated on a quarterly basis except in the case of $25 minimum dues for sole practitioners and other individuals.

Membership Form

FIRM MEMBERSHIP

Accounting Research Association
American Institute of
Certified Public Accountants
1211 Avenue of the Americas
New York, N.Y. 10036

Please enter membership of our firm in the Accounting Research Association for 1976. We have checked the applicable dues category in the schedule at the left.

firm

address

city state zip

individual authorizing membership

Dues payment enclosed

Please send bill

Check here if this is renewal of membership.

Note: You can help save us billing and administrative costs by enclosing your payment now. Please make your check payable to the Accounting Research Association.

ACCOUNTING
RESEARCH
ASSOCIATION

Statements on Management Advisory Services

Issued by the Management Advisory Services Executive Committee
American Institute of Certified Public Accountants

Preface

This publication presents a Statement on Management Advisory Services Practice Standards adopted in October 1974 by the Management Advisory Services Executive Committee. The Statement enumerates and comments on eight standards of practice, which provide specific criteria for the performance of management advisory services.

These standards are consistent with the accompanying three Statements on Management Advisory Services issued in 1969, which deal, respectively, with the nature of management advisory services, the competence required, and the practitioner's role in providing these services.

The Statement on Management Advisory Services Practice Standards was developed by the 1973-74 MAS Technical Standards Subcommittee, which consisted of the following members:

John P. Sullivan, *Chairman*
Clare J. Ackerman
George L. Bernstein
Herbert P. Dooskin
J. Russell Downey
Robert L. Herbert
Reginald L. Jones
Henry S. Moss
Robert D. Niemeyer
A. Marvin Strait
George Tasso
Virgil E. Wenger

John R. Mitchell, *Director*
Management Advisory Services

January 1975

Statement on Management Advisory Services No. 1

Tentative Description of the Nature of Management Advisory Services by Independent Accounting Firms

Issued by the 1968-69 Committee on Management Services
Date of issue, unless otherwise indicated, February 1969

Introduction

1. An independent accounting firm's purpose in engaging in management advisory services is to utilize the essential qualifications it has available to provide advice and technical assistance which will enable client management to conduct its affairs more effectively. These essential qualifications are based in part on attributes acquired in conducting other aspects of practice and include technical competence; familiarity with the client's finance and control systems and his business problems; analytical ability and experience in problem solution; professional independence, objectivity and integrity. Although not always identified as "management advisory services," independent accounting firms have rendered advice and assistance to clients outside the accounting, auditing and tax areas for as long as the accounting profession has existed.

The role of an independent accounting firm in performing management advisory services is to provide advice and technical assistance, and should provide for client participation in the analytical approach and process. Specifying this as the proper role recognizes both the appropriate place of management advisory services and the realities of practice. This is the only basis on which the work should be done and it is the only basis on which responsible management should permit it to be done.

When the services to a client also include expression of an opinion on the fairness of financial statements, the matter of role has special significance, since it also relates to the independence of the accounting firm. The accounting firm's role is to provide advice and technical assistance and to avoid making management decisions or taking positions that might impair the firm's objectivity.

2. In recent years, management advisory services have been in an accelerating process of evolution, with the profession's participation growing in response to requests from clients for assistance. In many instances, management needs and problems are more complex and the techniques involved in their solution more sophisticated than ever before. The profession's response to the demand for advice has been to develop a broader range of services.

3. The American Institute of Certified Public Accountants set forth the Institute's basic policy regarding management advisory services in the following resolution adopted by Council in April 1961:

> It is an objective of the Institute recognizing that management services activities are a proper function of CPAs, to encourage all CPAs to perform the entire range of management services consistent with their professional competence, ethical standards, and responsibility.

The Committee on Management Services believes that an interpretation of the phrase "the entire range of management services consistent with their professional competence, ethical standards, and responsibility," will contribute to the orderly implementation of this policy throughout the profession.

Subsequently, Council, in October 1966, adopted "A Description of the Professional Practice of Certified Public Accountants." Within the framework of this description, the committee believes that a further description of that portion of the practice generally referred to as management advisory services is desirable. Such an interpretation and further description will, among other things, serve to—

a. Guide independent accounting firms in selecting and practicing in areas of service in which they can and wish to render advice and technical assistance to clients beyond those relating to auditing, financial accounting, and taxes;

b. Assist those responsible for developing and conducting educational programs for CPAs; and

c. Provide a basis for the general business community to become better informed regarding the nature of management advisory services as performed by independent accounting firms.

Description of Management Advisory Services

4. Management advisory services by independent accounting firms can be described as the function of providing professional advisory (consulting) services, the primary purpose of which is to improve the client's use of its capabilities and resources to achieve the objectives of the organization. This can relate to areas such as—

- The management functions of analysis, planning, organizing, and controlling,
- The introduction of new ideas, concepts, and methods to management,
- The improvement of policies, procedures, systems, methods, and organizational relationships,
- The application and use of managerial accounting, control systems, data processing, and mathematical techniques and methods, and
- The conduct of special studies, preparation of recommendations, development of plans and programs, and provision of advice and technical assistance in their implementation.

In providing this advisory service, the independent accounting firm applies an analytical approach and process which typically involve—

- Ascertaining the pertinent facts and circumstances,
- Seeking and identifying objectives,
- Defining the problem or opportunity for improvement,
- Evaluating and determining possible solutions, and
- Presenting findings and recommendations,

and, following the client's decision to proceed, the independent accounting firm may also be involved in—

- Planning and scheduling actions to achieve the desired results, and
- Advising and providing technical assistance in implementing,

in combination with knowledge and experience in such areas as—

- Organization and management methods,
- Office and management functions,
- Systems and procedures,
- Data processing methods,
- Quantitative methods (mathematics, statistics, etc.), and
- Financial management,

to produce solutions such as—

- A management information system,
- A sales reporting system,
- A cost accounting system,
- A work measurement program,
- Improved production control,
- An organization plan with statements of duties and responsibilities, or
- An electronic data processing system.

5. The above represents a conceptual description of management advisory services rather than a definition in terms of area of application of the services. The committee believes that the adoption of an itemized "list of acceptable areas of service" would be useful; however, no generally accepted classification of subject matter currently exists for this purpose. Also, the validity and acceptability of such a list would have to be dependent on there being clearly discernible criteria for differentiating among the range of possible subject matter, and no such precise bases have yet been found.

There are several further reasons why the development of such a list appears to be unattainable. In the first place, many of the subject areas themselves do not have definitions which are precise and exclusive enough to be usable or acceptable in preparing the list. Second, the decisions regarding many of the subject areas, as being an "acceptable area of service," could depend on considerations of the underlying subareas with which the independent accounting firm is concerned (e.g., research per se vs. a system for the planning and control of manpower participating in research).

Third, the circumstances under which services are to be rendered in a particular subject area (a large vs. small client; a simple vs. complex problem) and the role of the independent accounting firm (as a fact-gatherer vs. a recommender vs. a technical implementor) would also be pertinent in the determination of the list.

Determining a Scope of Service

6. The committee believes that an independent accounting firm in reaching a decision as to the scope of its management advisory services should be guided by certain significant criteria established by the profession, such as competence and independence. Certain criteria will apply primarily to the profession as a whole, while others will be more relevant to the particular independent accounting firm or engagement.

7. The CPA's ability to learn and successfully apply the basic analytical approach and process is well recognized. The more difficult questions which must be answered by an independent accounting firm in determining a scope of management advisory services, however, relate to the depth of knowledge and experience required in the various subject areas and kinds of problems and solutions with which the firm might become involved. Since it is not possible to specify all the subject areas and types of problems with which independent accounting firms may be called upon to deal, the committee suggests the following guidelines which should be useful in selecting a scope of services.

General Guidelines

8. *Responsibility to Establish Scope of Services.* Each independent accounting firm has the responsibility to determine the scope of services it is competent to offer to the public, subject to the pronouncements of the profession. Each independent accounting firm should make its own decisions in accordance with the type of practice which it desires to conduct. It is anticipated that many firms will choose not to render management advisory services in all subject areas.

9. *Independence.* When providing management advisory services, the independent accounting firm must, as in all areas of practice, give particular consideration to independence as set forth in the Code of Professional Ethics[1] particularly in Rule 101. This rule states in part:

> A member or a firm of which he is a partner or shareholder shall not express an opinion on financial statements of an enterprise unless he and his firm are independent with respect to such enterprise.

A commentary entitled "Concepts of Professional Ethics," which was promulgated by the Division of Professional Ethics, elaborates:

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[1] As amended, effective March 1, 1973.

> Independence has traditionally been defined by the profession as the ability to act with integrity and objectivity. . . .
>
> When a CPA expresses an opinion on financial statements, not only the fact but also the appearance of integrity and objectivity is of particular importance. For this reason, the profession has adopted rules to prohibit the expression of such an opinion when relationships exist which might pose such a threat to integrity and objectivity as to exceed the strength of countervailing forces and restraints. These relationships fall into two general categories: (1) certain financial relationships with clients and (2) relationships in which a CPA is virtually part of management or an employee under management's control.
>
> Although the appearance of independence is not required in the case of management advisory services and tax practice, a CPA is encouraged to avoid the proscribed relationships with clients regardless of the type of services being rendered. In any event, the CPA, in all types of engagements, should refuse to subordinate his professional judgment to others and should express his conclusions honestly and objectively.

10. *Competence.* The scope of management advisory services of an independent accounting firm also depends on another fundamental and obvious matter—competence. Independent accounting firms have the responsibility to evaluate their ability to render management advisory services of a professional quality in each specific area. They also have the responsibility to refrain from representing themselves as qualified and willing to accept work in areas where they do not possess the required competence. Competence in professional work involves both the technical qualifications of staff personnel and the firm's ability to supervise and evaluate the quality of the work performed. Competence embraces both the analytical approach and process and the subject matter of the area involved.

The degree of competence required will naturally vary according to the degree of difficulty of the engagement and the importance of the recommendations for which the independent accounting firm will assume responsibility. It will also vary according to the role assumed by the firm—i.e., as an advisor, fact-gatherer or technical implementor.

The independent accounting firm will not always begin an engagement with a full and detailed knowledge of the characteristics of the business or of all of the techniques available for the solution of the problem, for no two situations faced by a firm are ever exactly the same, nor are the technical procedures required to achieve the desired result identical. The firm is expected to adapt its procedures and knowledge to the circumstances of the particular case and to research unfamiliar subject matter involved in the solution of the problem. In those instances in which the acquisition of the necessary knowledge is not a natural part of the conduct of the engagement as a result of the fact-gathering procedure or of the normal research process, the independent accounting firm should question its competence to carry out the engagement.[2]

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[2] This matter is considered more fully in MAS Statement No. 2, "Competence in Management Advisory Services."

11. *Other Considerations.* The scope of management advisory services is such that no one person can be expected to develop sufficient specialized knowledge and skill in all areas in which clients might require assistance. A wide range of management advisory services can normally be performed only by a firm which includes both generalists and individuals who have acquired specialized qualifications in the subject matters or techniques involved. Accordingly, the requirements for specialization in certain areas may limit the scope of management advisory services offered by any given independent accounting firm. As a result, many independent accounting firms will decide on a scope of practice which does not include areas of service offered by others in the profession.

The scope of services offered by the independent accounting firm also should be adequate to identify and resolve the clients' basic problems and not just problem symptoms. If the scope is excessively narrow, there is a danger that the problem may be defined and solutions developed from too narrow a point of view to be really useful to the client.

12. *Referrals.* Referral of management advisory services work to other independent accounting firms is an alternative course of action to that of developing individual or firm capability. Recognizing the depth and breadth of skills required to deal effectively with the clients' basic problems and the economic limits of practice, the independent accounting firm's sense of responsibility to its clients may in some or all instances lead it to refer the management advisory services requirements of its clients to others. The referral arrangement may provide for a joint effort or provide for the services to be performed solely by the referee brought in for that purpose. In any event, to the extent that the independent accounting firm finds an effective way to cooperate with others, it may thereby expand its own knowledge and extend its own scope of service toward providing the full range of management advisory services.

13. *The Code of Professional Ethics.* The applicability of the Code of Professional Ethics to management advisory services is clearly stated in the introductory section of the Rules of Conduct as follows: "The Rules of Conduct . . . apply to all services performed in the practice of public accounting including tax and management advisory services except (a) where the wording of the rule indicates otherwise and (b) that a member who is practicing outside the United States will not be subject to discipline [except under certain specified conditions]."[3] It is, therefore, the responsibility of the independent accounting firm to assure itself that the nature and scope of the management advisory services it elects to offer are in conformity with this requirement.

Conclusion

14. The American Institute of Certified Public Accountants, recognizing the needs of the business public and the long record of substantial and va-

[3] As amended, effective March 1, 1973.

ried accomplishments by independent accounting firms in rendering management advisory services, has encouraged and continues to encourage firms to develop capabilities in this field.

The appropriate range of services for the profession and the accounting firm should depend on considerations of—

- Responsibility of the independent accounting firm to establish its scope of services,
- Independence,
- Competence,
- Requirements for specialization,
- Attention to the client's basic problems,
- Referral arrangements, and
- The Code of Professional Ethics.

This statement has described the nature of management advisory services by independent accounting firms and is intended to provide guidelines for determining a scope of service and to serve as a basis for future statements in this area of practice.

(From the Washington Post, Nov. 2, 1973.)

Republican Pressure For Funds Probed

By Morton Mintz
Washington Post Staff Writer

Federal prosecutors in New York City are investigating a persistent attempt by top fund-raisers for President Nixon's re-election campaign to solicit at least $100,000 from partners in the nation's largest firm of certified public accountants, The Washington Post was told yesterday.

The firm, Peat Marwick Mitchell & Co., rejected the solicitation on the ground that any effort to influence partners to give to a particular party or candidate would violate a federal law prohibiting contributions by government contractors.

But Maurice H. Stans, chairman of the Finance Committee to Re-elect the President, brushed off the objection, PMM general counsel, Victor M. Earle III, said in a telephone interview.

He said Stans told the firm's senior partner, Walter E. Hanson, "Don't worry about that statute. The fact that you're a government contractor is all the more reason for you to give."

Stans denied having made the statement. He also said he had gotten legal opinions in advance that said it was lawful for a partner, or for an employee of a partnership, to make a political contribution. Stans' comments were relayed by his Washington attorney, Robert W. Barker.

Earle, confirming an account given to a reporter by a Capitol Hill source, said he and Hanson were interviewed recently by John R. Wing, chief of the Criminal Frauds Division in the office of the U.S. attorney in New York, apparently in connection with an "on-going grand jury investigation."

"We absolutely can't comment," Wing said. "I can't say if the grand jury is investigating anything."

Earle was reached in Boca Raton, Fla., where PMM is having its annual meeting. The largest of the "big eight" accounting firms, it now has about 725 partners and accountancy income in the United States of $240 million (plus $110 million in other countries).

Earle said Stans phoned Hanson on March 7, 1972. This was about a month after the Securities and Ex-

change Commission had filed fraud charges against PMM in connection with an acquisition by the national student Marketing Corp., and precisely a month before an election-financing disclosure law was to take effect.

Earle said Stans emphasized that a contribution should be made before April 7 the disclosure law's effective date. The date appears [illegible] written notes. Han[illegible] made during the phone conversation with the former Commerce Secretary, a one-time president of the American Institute of Certified Public Accountants.

Earle said Stans also emphasized that PMM should make a contribution from its partners in six figures, as each of the other firms in the "big eight" was said by Stans to be doing.

Hanson refused, citing Earle's advice that PMM could not legally do so because it held "very substantial" management-consultant and auditing contracts with the Department of Transportation and other federal agencies, Earle said.

"This was pressure," Earle said. "The bite was on."

Finally, Stans asked for and was given the name of the firm's counsel, so that Stans could have his lawyer call him. That lawyer was John W. Dean III, then the White House counsel—a point that Earle said eluded him and Hanson at the time.

The attorney who shortly phoned Earle, however, was Thomas B. Evans Jr. He was co-chairman of the Republican National Committee from January, 1971, to January, 1973, but has returned full-time to Mudge Rose Guthrie & Alexander, formerly the law firm of President Nixon and former Attorney General John N. Mitchell.

Mitchell and Stans are to go to trial in January on an indictment charging obstruction of justice in connection with a $200,000 contribution of currency by financier Robert L. Vesco, who was trying to head off a criminal prosecution by the SEC.

Earle said he was surprised to be phoned by Evans, an acquaintance who had preceded him by about two years at Williams College and Columbia University law school.

Earle told the reporter that an individual in a partnership with a federal contract is of course free to give as he chooses.

But, Earle said, "if in the slightest way the firm suggested, hinted or encouraged individual partners to give to a particular party or candidate, that would be tantamount to the firm making a contribution, which is prohibited."

Evans argued with this interpretation, terming the law "a dead letter" that has not been enforced. "I said I

didn't care whether it had been enforced, because it was so clearly stated that it applied to us as a government contractor," the PMM counsel continued.

Evans could not be reached.

About five months after the incident, on Aug. 7, 1972, the SEC staff criticized PMM, among others, in a report on the Penn Central Railroad bankruptcy.

On Tuesday, the agency charged Talley Industries, Inc., and its accountant, PMM, with using false proxy materials in connection with Talley's controversial take-over of General Time Corp.

Among other "big eight" firms, 194 partners in Arthur Andersen & Co., the accountant for Amtrak since its inception in May, 1971, gave $55,467 to the Nixon reelection drive before the disclosure law took effect.

Partners in Ernst & Ernst gave acomparable sum. The firm said that others gave to Democratic presidential candidate George McGovern. The firm audits statistics for hte Washington police department and other agencies.

Touche Ross & Co. said it asked none of its 450 partners to contribute to either candidate. Price, Waterhouse partners gave substantial sums, mainly to the Nixon campaign. Coopers and Lybrand said Stans sought funds, but the firm exerted "no pressure." while it "passed out the word."

Arthur Young & Co. said it did not make a contribution to the Nixon drive. Haskins & Sells said it was "unaware" of any request by Stans. Ernst & Ernst's Baker said it was "God's truth" that neither Stans nor the Democrats asked for funds.

(From the Wall Street Journal, Jan. 19, 1976)

Accountants Group Clears Maurice Stans On Ethics Charges

* * *

Hearing Involved His Plea Of Guilty to Misdemeanors In Nixon's 1972 Campaign

By FREDERICK ANDREWS
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK — The American Institute of Certified Public Accountants has cleared Maurice H. Stans of charges of unethical conduct involving his guilty plea last year to campaign-finance misdemeanors as finance chairman of President Nixon's re-election campaign.

Specifically, the institute's ethics division had charged that Mr. Stans's guilty plea to the five misdemeanors, as well as the acts themselves, brought discredit upon the accounting profession. Mr. Stans, a former president of the accounting institute, was found innocent after a full-day hearing before a five-member subcommittee of the institute's 21-member trial board, its highest authority on ethical matters.

Donald Schneeman, the institute's general counsel, said the disciplinary charges concerned only the five misdemeanors and didn't encompass other controversies, such as Mr. Stans's 1973 indictment for obstruction of justice and perjury. Mr. Stans was acquitted on those charges in 1974. In an interview yesterday, Robert W. Barker, Mr. Stans's lawyer, said the institute staff had investigated "a wide spectrum of matters," but chose to bring only the charges involving the misdemeanors.

Disclosure Requested

The trial board's verdict was made public in the institute's monthly newsletter to members. Normally, an ethics proceeding remains confidential, especially where the charges are found unproven, but Mr. Stans requested that the verdict be disclosed, the institute said.

Before the trial board last Oct. 28, Mr. Stans contended that the campaign-finance offenses were minor and technical, that a federal court had judged them unwillful, and that he had handled the underlying transactions in good faith.

The accounting institute's maximum sanction would have been expulsion from membership. A certified public accountant's license to practice is controlled by boards of accountancy in the various states, not by the accounting institute.

[illegible] several states, Mr. Barker said he wasn't aware of any state disciplinary proceedings under way against his client.

Gold Medal Winner

Mr. Stans was president of the accounting institute in 1954-55, and in 1954 he received its Gold Medal, its highest honor.

The institute declined to say whether the charges against Mr. Stans were brought on its own behalf or because of complaints by other members. In early 1973, Abraham J. Briloff, an accounting professor at the City University of New York, filed a complaint with the institute concerning Mr. Stans's part in the 1972 campaign.

Prof. Briloff yesterday described the institute's verdict as "sort of sad." "I believe (Mr. Stans) failed in fulfillment of responsibilities vested in him by society," the professor said.

Mr. Stans "had no business twisting arms in order to get contributions for the President," Prof. Briloff charged. "To be involved in the destruction of records was an abdication of professional responsibility, especially by someone trained as an accountant."

(From the New York Times, Jan. 20, 1976)

Accountants' Board Clears Stans of Ethics Charge

By RICHARD PHALON

A trial board of the American Institute of Certified Public Accountants has found Maurice H. Stans, former Secretary of Commerce and chief fund raiser for Richard M. Nixon's 1972 Presidential campaign, not guilty of bringing discredit on the accounting profession.

Mr. Stans has been a member of the accountants' group since 1932 and served a one-year term as president of the organization in 1955. The ethics charge against Mr. Stans grew out of his plea of guilty last March in Federal District Court in Washington to five misdemeanor counts.

The five counts, reduced from felonies in an arrangement with the Watergate special prosecutor, charged Mr. Stans with accepting illegal corporation contributions on behalf of the Nixon campaign and with failing to account for transactions that should have been reported by others to the General Accounting Office.

In a regular semimonthly newsletter to its 116,000 members dated Jan. 12, the organization reported that a five-man trial board had found "the charges of the ethics division had not been proved."

All-Day Hearing

Mr. Stans argued in his own behalf at an all-day hearing held by a sub-trial board set up by the full 21-man trial board on Oct. 28, 1975.

The newsletter said, "Mr. Stans contended that the of-cal; that they had been found by the court to be unwillful, and that the transactions upon which they were based had been handled by him in good faith."

That is essentially what Mr. Stans maintained after he was fined $5,000 last May. The plea bargain he struck reduced the nature of the charges from "willful" to "nonwillful."

The information enumerating the misdemeanors to which Mr. Stans pleaded did not say so, but a chart introduced by the prosecution in the Watergate cover-up trial indicated that much of the $150,000 in contributions that Mr. Stans had failed to account for had been transferred to individuals who passed "hush money" on to the Watergate burglars.

The A.I.C.P.A. formulates accounting principles, but has no licensing powers. The maximum sanction that it could have invoked against Mr. Stans, who is 67 years old and now a part-time business consultant, would have been expulsion.

Mr. Stans has apparently done no public accounting since 1955, when he left the Chicago firm of Alexander Grant & Company to become a Deputy Postmaster General.

Donald J. Schneeman, general counsel for the accountants' organization, said yesterday that he thought Mr. Stans's inactivity in the field might have been one of the reasons the trial board had found him not guilty.

"How can you find someone guilty of bringing discredit on a profession in which they're not working?" Mr. Schneeman asked.

Abraham J. Briloff, an accounting professor at the City University of New York, said yesterday that Mr. Stans had been identified as an accountant in many articles on Watergate. The organization's decision, said Mr. Briloff, who filed a complaint with the organization against Mr. Stans in March 1973, left him "sort of sad."

THE SEARCH FOR FAIRNESS IN FINANCIAL REPORTING

by Wallace E. Olson, President
American Institute of Certified Public Accountants
before the L.A. Chapter, California Society of CPAs, Los Angeles, Calif.
March 23, 1976

The search for fairness in financial reporting has been an agonizing process that has spanned several decades and now threatens to burst forth in a renewed and more determined effort than ever before. No doubt this quest is as old as the evolution of accounting and financial statements. It received its major impetus, however, when the first securities law was enacted by Congress in 1933 decreeing that financial statements used in connection with securities transactions should be "not misleading."

More than forty years have passed since the adoption of the 1933 act. During that period we have witnessed an outpouring of rules, regulations, releases and opinions directed toward defining what is meant by the elusive term "not misleading." Unfortunately the task remains incomplete and it sometimes seems that the more we seek a magic answer the more we succeed in compounding the complexities that we strive to clarify.

The concern about fairness and reliability in financial reporting has reached such high intensity that it has become the subject of widespread debate and is the object of a host of special studies, research projects and proposals for change.

There are many developments in our society which have

converged in recent times to bring about this heightened interest in financial reporting. Principal among these has been the social upheaval that began in our country in the 1960s. We have witnessed the emergence of concern for protection of the consumer and preservation of the environment and disenchantment with big government and with social programs that fell far short of their mark. We have been abruptly confronted with the spectre of shortages in energy and other natural resources vital to the health of our economy. We have experienced a collapse in the stock markets following a period of unparalleled boom and a spurt in inflation resulting largely from fiscal irresponsibility. We have seen the stability of our banking system come under question as a result of bad loans to real estate investment trusts and less developed countries and on such things as oil tankers.

The costs of government have burgeoned to unprecedented heights because we have tried to do more than we could afford. As a result major governmental units are now faced with default and bankruptcy. Faith in the credit of state and local governments has been badly shaken and their ability to raise needed capital has been severely damaged.

In the private sector, business has gone through a series of damaging trends and events. In the 1960s there were

the go-go managers who parlayed small companies into giant conglomerates through accounting manipulations that ultimately resulted in the bilking of hordes of small investors. These were accompanied by the spectacular collapse of a number of prominent companies whose securities were thought to be outstanding investments. The demise of such companies as Penn Central and Equity Funding has taken a toll in public confidence that may never be fully restored.

The management cover-ups and frauds that came to light over the last decade were the forerunners of corporate misdeed of unimagined pervasiveness. The revelations about corporate bribes, illegal political contributions and other assorted irregularities which are currently unfolding are leading to demands for disclosure and openess that are likely to eliminate most remaining vestiges of privacy of financial information.

Couple all of these developments with a major recession and the resignation under fire of a President of the United States and there is little wonder why a crisis of confidence in nearly all of our institutions exists today. Clearly, if confidence is to be restored, there must be a renewed dedication to integrity and assurance of integrity must be provided by, among other means, fairness in financial reporting.

It is as a result of this environment that we find

ourselves caught up in an intensive scrutiny of the adequacy of financial reporting practices which are based on long-held assumptions or conventions that may no longer be valid. The experience of a troubled economy has focused attention on the need for reliable financial data on which sound economic policy decisions can be based. The ravages of double-digit inflation have sharpened awareness of the need for financial accounting that reflects changes in current values and the purchasing power of money.

It is no accident then that our Congress is turning its attention to the financial reporting process. In developing an energy bill, it provided for the establishment of accounting standards for the oil and gas industry. In hearings on pending legislation to regulate the sale of state and municipal securities, it is indicating an intention to see that adequate disclosure standards are adopted and adhered to. The Congressional investigations of illegal corporate payments are directed at devising methods of preventing similar abuses in the future.

Both Congress and the Executive branch are concerned about the functioning of our capital markets and the prospects of a capital shortfall that will hinder the future growth of our economy. The securities industry has already undergone a period of substantial change mandated by legislation and even more change is in prospect. The financial reporting process

is an important part of this picture and is not likely to be overlooked. Thus the ranks of those seeking fairness in reporting financial data have swelled to include politicans, union leaders, economists, environmentalists, social reformers and many others.

All of this has created strong pressure to bring about immediate changes in financial reporting to better meet the needs of our times. The problem is that little agreement exists among the interested parties on what constitutes fairness, and on how to achieve it. In short, we are in considerable disarray even though the task of determining what should be done has become urgent.

There have been a host of efforts to achieve fairness in financial reporting ever since Congress and the SEC decided to rely principally on the CPA profession for this purpose. To be sure, over the years, the SEC has established rules and issued accounting series releases of its own, but until recently it relied heavily on the practicing profession to take the initiative.

In 1938 the AICPA established its Committee on Accounting Procedure to establish standards in the form of Accounting Research Bulletins. A total of 51 bulletins were issued until the Committee was replaced by the Accounting Principles Board in 1959.

The APB started slowly but ultimately released a total of 31 opinions dealing with a wide variety of accounting problems. Nevertheless, the pressures of its critics brought about the appointment of the Wheat Study Group to reexamine the manner in which accounting standards should be established. This study resulted in the establishment of the Financial Accounting Standards Board in 1972 to succeed the APB as the body in the private sector to establish financial accounting standards.

No doubt you are all aware of the activities of the FASB since it was established. It has sought to generate a broad base of support for its pronouncements by the adoption of extensive due process procedures. The SEC has indicated its support for the work of the FASB by issuing Accounting Series Release 150 confirming its intention to rely on the Board for the establishment of accounting measurement standards.

The Board has issued 12 statements and 9 interpretations to date and has 16 matters on its active agenda. Despite these concerted efforts, however, it is being criticized for acting too slowly, for failing to develop a conceptual framework of accounting, for devoting too much attention to dealing with urgent emerging problems and for the quality of its decisions to date.

In the meantime. the SEC. under heavy pressure from

Congress, financial analysts and other critics to deal with urgent accounting problems through disclosure requirements, has issued 65 Accounting Series Releases from 1972 to the present date. In doing so, the SEC has distinguished between disclosure standards, which it considers to be its province, and measurement standards for which it looks to the FASB.

With all this activity one might think that most of the problems were being resolved and that the search for fairness was rapidly reaching its objective. This is far from being the case, however. Far too many major issues remain unresolved. A quick look at the open items on the agenda of the FASB is sufficient to convince one that we still have a long way to go. For example, the accounting for leases, the extractive industries, and interest costs must all be dealt with. We still have no resolution of how to report on segments of a business and the problem of defining what is material for financial reporting purposes remains as perplexing as ever.

In addition to these specific problems are matters of lesser magnitude but of greater urgency because they have emerged from new circumstances being encountered by preparers of financial statements and auditors alike. These emerging problems require prompt solution if a reasonable degree of comparability is to be achieved.

During the early days of the FASB, the AICPA's

Accounting Standards Executive Committee dealt with such problems on an interim basis by the issuance of Statements of Position. While AICPA members are not required to follow these Statements, they do provide guidance for members until the FASB takes action.

More recently, the FASB has established procedures for attempting to deal with emerging problems on a timely basis. It is too early to tell whether this approach will prove satisfactory or whether it will place too heavy a burden on the Board's time.

Meanwhile, other major areas of accounting are going untended by the FASB. The entire field of accounting for non-profit enterprises demands attention. As mentioned earlier, the need for more comprehensive accounting and reporting standards for state and local governments has become painfully obvious as a result of recent financing difficulties. Also, many industries have operating characteristics that give rise to the need for special accounting standards.

In some cases industry groups are springing up to take these accounting matters into their own hands. Some, like the Municipal Finance Officers Association, are responsible groups which ought to be commended for their efforts. But others may be solely concerned with protecting vested interests rather than the public.

The AICPA is attempting to fill some of these voids in accounting standards on an interim basis. Its Accounting Standards Executive Committee is issuing position papers on matters that the FASB does not add to its own agenda. A variety of committees and task forces are working on the development of new or revised audit and accounting guides for special industries, on state and local government accounting and on accounting for non-profit enterprises. But the present situation is not wholly satisfactory.

The Institute's pronouncements are not enforceable under our Code of Professional Ethics and thus they lack the necessary force to ensure the achievement of comparability in financial reporting. On the other hand it is unrealistic to expect the FASB to be able to deal with all of these problems within the foreseeable future. There is a need for some means of establishing interim standards on a semi-official basis within the profession until such time as the FASB can take official action. If this need is not met, either a variety of industry groups will be established to fill the void or even more diverse accounting practices will be the order of the day. In either case, the quality of financial reporting and comparability are likely to suffer. The profession ought to give prompt consideration to this problem in conjunction with those groups who have a high interest in achieving fairness in financial reporting.

I have cited these problems under the present structure, not for the purpose of being critical of the FASB, but to illustrate how exceedingly difficult it is to establish a comprehensive set of financial accounting and reporting standards. There are many who have already become impatient with the rate of progress of the FASB and have suggested various actions as a panacea. Perhaps the most important of the criticisms has been that the Board should have established a conceptual framework for accounting before attempting to establish specific standards for measurement and disclosure. It is argued that a conceptual framework will provide guide-posts which will greatly simplify reaching decisions on the appropriate standards to be adopted. Advocates of this approach suggest that it will provide a basis for attaining internal consistency within the body of standards as they are promulgated. It is asserted that this would avoid the kind of ad hoc fire-fighting approach to standard setting for which both the APB and now the FASB have been criticized.

There are strongly held views on both sides of this proposition. Those who support the notion of a conceptual framework are found principally among the academic members of the profession. The other side is mainly composed of practi-tioners who want to have resolved immediately the questions they currently face in conducting their audits. The APB sought

to straddle this issue by trying to do both at the same time and so far the FASB has followed a similar course. It remains to be seen whether it will be any more successful in this endeavor than was the APB. Regardless of the outcome, neither of these bodies realistically had any choice but to deal promptly with urgent issues if they were to continue to be accepted as viable standard-setting organizations. The political pressures of the market place would not have permitted any other approach.

There have been several attempts in the past to establish a basic set of principles as guideposts for standard-setting. The APB's Statement No. 4 on the Fundamentals of Financial Accounting was intended as a start toward this purpose. It is an excellent compendium of principles which underlie current practices. However, it was more an inventory than an internally consistent conceptual framework, and it was criticized precisely for that reason. In any event, it did not prove to be the key that could unlock all the solutions to the complex questions encountered in establishing accounting standards.

The American Accounting Association also grappled with this subject by appointing a committee which published "A Statement of Basic Accounting Theory" in 1966. This effort also met with little success in achieving the basic objective of facilitating the standard-setting process.

A third, and more ambitious effort, was the appointment by the AICPA in 1971 of a study group under the chairmanship of Robert Trueblood to develop a statement of the objectives of financial statements. The work of this group culminated in a report published two years later. Although it identified 11 objectives, it did so in such broad terms that they did not lend themselves to direct application in establishing accounting standards.

The FASB has made the Trueblood report on objectives the centerpiece for its current project to develop a conceptual framework for accounting. It is anticipated that a discussion memorandum reflecting the results of the FASB's own research on the issues will be published in May or June of this year. Until then we can only speculate about the potential success of this latest effort.

We do know that at least two principal issues have been under consideration in the development of the discussion memorandum. One of these is the question of what should constitute income for accounting purposes. Some have argued that income should be simply the sum of the difference in balance sheet values between the beginning and the end of a fiscal year. This approach places great emphasis on establishing current values in the balance sheet accounts and de-emphasizes the concept of matching expenses with revenues. Others contend

that the emphasis in accounting should be just the reverse.

While I recognize that there are important differences in these two approaches to determining income, I am not at all certain that in implementing their application the results would be significantly different. In any event it is hard to see how the resolution of this issue will, by itself, constitute the flawless set of basic principles that have been so long sought. It would, however, provide useful direction in establishing standards.

A related issue being considered under the FASB's conceptual framework project is the question of whether one or more valuation schemes should replace historical cost as the basis for financial reporting. We are all aware of the mounting pressures that exist today to produce financial data that more accurately reflects economic values. The concerns about the impact of inflation and the need for maintenance of capital have reached a point where a major overhaul of the valuation basis used in accounting must be given serious consideration.

The implications of changing to one or more methods of current value accounting are, of course, staggering. The impact on the securities markets, the federal income tax base and the nation's productive facilities are not even dimly discernible -- to say nothing of the difficulties of

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implementation for preparers and auditors alike. Nevertheless, since the need for more realistic financial data is undeniable, there seems little doubt that the development of a workable scheme must be initiated forthwith.

The notion that accounting should be modified to reflect the effects of inflation is not new. In 1959 the APB issued its Statement No. 3 titled "Financial Statements Restated for General Price Level Changes." This statement encouraged the inclusion of supplemental financial information which would reflect restatement for changes in the purchasing power of the dollar based upon a general price level index. Except in a few isolated cases, the recommendation was not implemented, and it went largely ignored until it was incorporated in the pending proposal of the FASB in the form of an exposure draft on Financial Reporting in Units of General Purchasing Power.

Adoption of that exposure draft was deferred to permit experimentation with its application. It is perhaps safe to say that most commentators have expressed little enthusiasm for general-purchasing-power financial statements. The negative response reflects a variety of reasons -- including self-interest, lack of understanding, a feeling that the results have little practical utility, and a belief that adjustment of balance sheet values rather than a change in the unit of measure would be far more useful.

Also, the SEC's Chief Accountant is less than ecstatic about the adoption of a general purchasing power approach. Mr. Burton has expressed concern that application of a single index to the financial information of all types of companies would not produce useful results. He worries that its adoption would divert the efforts of preparers and the accounting profession from experimenting with current replacement costs, which he considers to be a more desirable course to pursue

Consistent with this conviction, the SEC issued its Release No. 5608 on August 21, 1975 proposing that filing companies calculate and reflect in a footnote to their financial statements the current replacement costs of inventories and productive plant and equipment. The footnote would also disclose the effects on depreciation and cost of sales of using such values. We are told that the release will be adopted and issued as an Accounting Series Release in April or May of this year despite the fact that both industry and the profession have urged that the requirement be deferred until more experience is gained in estimating current replacement costs. Even though this information will be labelled "unaudited", there is fear that users of financial statements will regard it as something more than experimental data. Moreover, because it is only a piecemeal approach, there are strong views that the costs that will be encountered will far outweigh the utility of the

information. It appears that once more the SEC is taking the initiative because it considers action is so urgently needed that it cannot afford to await experimentation and development efforts in the private sector.

Significant attempts are also being made in the United Kingdom, Canada and Australia to cope with inflation and to reflect current values in financial statements. The most important of these are in England where the accounting profession is attempting to implement its own provisional requirement for supplemental financial statements restated for changes in the general purchasing power of the pound. This proposal so alarmed the government that it appointed a special study commission which has issued its own report, known as the Sandilands Commission Report on "Inflation Accounting". This report specificially rejects restatement for changes in the purchasing power of money as a satisfactory solution. Instead, it recommends changing from the use of historical costs to the incorporation of current replacement costs in the accounts for certain classes of non-monetary assets.

At the present time a special committee is being jointly financed by the government and the profession in the United Kingdom to coordinate the two approaches and develop procedures for their implementation. There has been some

thought that the new value systems of accounting that emerge may be adopted by the government for purposes of taxation.

It seems clear from all of these developments that we are moving rapidly toward a period of extensive experimentation with new valuation schemes for accounting. In my view this is long overdue. But the implications of such fundamental and far-reaching changes are so extensive and so unclear that we should proceed with great caution lest we create widespread chaos that would destroy rather than improve confidence in financial reporting.

The SEC ought to forego implementing its proposed footnote disclosure requirement until a coordinated program for experimentation can be effectively carried out. The accounting profession, working in coordination with the FASB, should agree on a few tentative approaches to a system incorporating current value and possibly purchasing power accounting and then proceed with a well-organized plan of experimenting with a representative sample of major companies. This should be initiated at the earliest possible date and should also be coordinated with the work currently being carried out in the United Kingdom. Only a major joint effort of this nature is likely to avoid the confusion and inefficiency that will otherwise result from the piecemeal and disparate efforts that are presently being proposed.

In developing an overall scheme for improved financial reporting, a third major question to be dealt with is the kinds of information and data that should be disclosed and how it should be reported. We are in the midst of a period of proliferating disclosure requirements and have reached a point where the footnotes in many cases overshadow the financial statements. There is widespread concern that an overload of disclosure may be counter-productive to understanding and that the benefits may not be worth the costs involved.

The basic assumption of the SEC that mandatory disclosure rules are essential for a fair market in securities has been sharply challenged by the findings of a number of researchers. These challenges, combined with the growing resistance to the burden of ever-expanding disclosure requirements, has prompted the SEC to appoint a special study group under the chairmanship of Commissioner Sommer to reexamine the whole subject of disclosure theory and policy. This study will almost unavoidably overlap the work of the FASB's conceptual framework project.

There is little doubt that a reconsideration at this time is highly desirable, but it seems unlikely that there will be a reduction in either the volume or complexity of required disclosures. Indeed, in the light of the present distrust of business, the prospect is for more disclosure rather than less.

There is ample evidence to support this conclusion. We are embarking on the inclusion of quarterly financial data in footnotes to annual financial statements; the issue of publication of forecasts is not dead; the revelations on illegal payments are now finding their way into disclosures in proxy statements; we are still struggling with how to report on segments of conglomerates; and our concepts of materiality are being stretched beyond traditional boundaries.

Where are we going with this insatiable demand for more and more information? Is it all really necessary? Who uses it and how and to what effect? Are the traditional rights to privacy going to be obliterated in the name of the public's need to know? Is the SEC's theory of differential disclosure valid or is it a rationalization of outmoded assumptions? Are we attempting to remove more risk from investment decisions than we can or should? If management and securities market fraud is our principal concern are there more effective ways than disclosure to deal with the problem?

I don't pretend to have the answers to these difficult questions. Neither am I sanguine about any early or wholly satisfactory success in our quest for fairness in financial reporting. We have a long way to go and I am not at all sure that we aren't seeking certainty in a world that is filled with uncertainty.

It does seem to me, however, that one important aspect of financial reporting is being largely overlooked. This is the manner in which financial reports communicate information. Very little has been done to experiment with new formats and techniques of communication to achieve a better understanding by users. We are still using essentially the same type of financial statements that were devised at a time when business entities and transactions were relatively uncomplicated. A reexamination of the present methods of communication would seem to be overdue.

It is likely that the FASB's conceptual framework project and the SEC's proposed disclosure study will deal with some aspects of the communication process. However, these projects do not appear to be directed at an appraisal of the communication techniques, as such, but are more concerned with the information itself. A study of the communication methods used in financial reporting ought to be initiated at the earliest practicable date.

A preliminary effort in this area has already been completed by the English Institute of Chartered Accountants and published under the title "The Corporate Report" in July 1975. It would be very helpful if preparers and the CPA profession were to join forces to mount a similar effort to develop more effective methods of communicating financial information.

This might provide an important part of the answer to how to keep the volume of disclosure within reasonable bounds.

It may be that our search for fairness in financial reporting is founded on a false notion about the degree of perfection that is achievable. An article in the March 15, 1976 issue of Forbes magazine entitled "Waist Deep in Big Muddy" had this to say on the subject:

> "It is a funny thing about accounting: the deeper you get, the more confusing it gets. The harder you try for the precise truth, the more it eludes you."

Perhaps we ought to ask ourselves whether it will ever be possible to condense the complexities of a modern multi-national corporation into a few pages of financial data that will convey a fair picture. It may be that a better answer would be to concentrate on those factors or circumstances relating to a company which, by their unique circumstances, are likely to have an over-riding effect on the success or failure of the company. It is this information that needs to be summarized and communicated and it is unlikely that it can ever be done effectively within a rigid reporting framework.

What users need is an interpretation and analysis of what the financial data means in terms of the present condition

and future proposects of a business.

It is not very satisfactory to give users of financial reports a lot of financial data and tell them to make their own analysis and interpretation. What they need is to be told what the financial data means in terms of the operations, financial condition and future prospects of the business.

It seems to me that management is in the best position to do this and should be charged with providing such information in new formats that would include sections dealing with the key aspects of the business such as production facilities; sales, order backlogs, marketing programs and product development; work force and labor relations; and working capital. We have already started in this direction as a result of the SEC's requirement for a management analysis of the summary of operations. What I am suggesting is that this approach be expanded and refined to take the place of many of the disclosures which are currently included in financial statements and footnotes.

If this course is pursued, auditors should be required to review and report on the reasonableness of management's analysis and interpretation. This role would admittedly be difficult for auditors to fill and would require a high degree of professional judgment and integrity. But the need is great

and I am convinced that over a period of time a group of sophisticated practitioners would emerge to fill this role.

In the meantime we shall carry our lighted lantern before us seeking fairness while standing waist deep in a swamp of disclosures at the height of the rainy season. Maybe by some judicious tinkering we can at least stop the rain and make our way to improved methods of financial reporting.

REPRESENTATION OF THE BIG 8 ACCOUNTING FIRMS
ON AICPA COMMITTEES
(Prepared by the subcommittee staff)

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
AAA/AICPA Committee on Doctoral Fellows and Visiting Scholars	Arthur Andersen & Co. George C. Beacham, Jr. Haskins & Sells Edwin R. Lang	2 of 7	28.6%
Accountants' Legal Liability Committee	Ernst & Ernst Edwin F. Cathcart Peat, Marwick, Mitchell & Co. Victor M. Earle, III Price Waterhouse & Co. Richard D. Fitzgerald Touche Ross & Co. Carleton H. Griffin Haskins & Sells Thomas B. Hogan Arthur Andersen & Co. Charles R. Jewell Arthur Young & Company William S. Kanaga Coopers & Lybrand Fred J. Sengstacke	8 of 16	50%
AICPA Professional Liability Insurance Plan Subcommittee	none	0 of 7	--
Accounting Literature Awards Committee	none	0 of 5	-
Accounting Research Association, Inc.	Haskins & Sells * Michael N. Chetkovich	1 of 6	16.7%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Accounting Standards Executive Committee	Price Waterhouse & Co. *Raymond C. Lauver Haskins & Sells Hector R. Anton Touche Ross & Co. Robert S. Kay Coopers & Lybrand James J. Quinn Ernst & Ernst Harry F. Reiss, Jr. Arthur Young & Company Fred L. Tepperman Peat, Marwick, Mitchell & Co. George R. Vogt Arthur Andersen & Co. Arthur R. Wyatt	8 of 15	53.3%
Social Measurement Subcommittee	Price Waterhouse & Co. *Arthur B. Toan, Jr. Ernst & Ernst Dennis R. Beresford Arthur Andersen & Co. John L. Fairfield Touche Ross & Co. Martin S. Gans Peat, Marwick, Mitchell & Co. Robert L. Sullivan	5 of 10	50%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Relations With Actuaries Committee	Price Waterhouse & Co. *Donald H. Trautlein Peat, Marwick, Mitchell & Co. Andrew J. Capelli Touche Ross & Co. Dane W. Charles Haskins & Sells Joseph E. Elmlinger Ernst & Ernst Paul W. Horsley Arthur Young & Company Randolph H. Waterfield, Jr. Coopers & Lybrand Aldo C. Zucaro	7 of 9	77.8%
Advisory Committees	Peat, Marwick, Mitchell & Co. * Walter E. Hanson	1 of 5	20.0%
AICPA Staff Pension Plan Committee	Peat, Marwick, Mitchell & Co. *Walter E. Hanson Price Waterhouse & Co. John W. Zick	2 of 3	66.7%
American Institute Benevolent Fund, Inc.	Price Waterhouse & Co. John W. Zick	1 of 7	14.3%
American Institute of Certified Public Accountants Foundation	Price Waterhouse & Co. John W. Zick	1 of 6	16.7%
Annual Meeting Hospitality Committee	Price Waterhouse & Co. *John B. O'Hara	1 of 2	50.0%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Auditing Standards Executive Committee	Coopers & Lybrand *Kenneth P. Johnson Haskins & Sells J. Michael Cook Touche Ross & Co. James I. Konkel Arthur Young & Company Edwin M. Lamb Ernst & Ernst Blaine C. Lisk Arthur Andersen & Co. Robert L. May Peat, Marwick, Mitchell & Co. Messim A. Tiano Price Waterhouse & Co. Donald R. Ziegler	8 of 21	38.1%
State and Local Government Auditing Subcommittee	Arthur Young & Company *C. Richard Spriggs Touche Ross & Co. Frank S. Belluomini Coopers & Lybrand James L. Savage Peat, Marwick, Mitchell & Co. Harold I. Steinberg Ernst & Ernst Joseph G. Tonascia Price Waterhouse & Co. Benton B. Warder	6 of 15	40.0%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Statistical Sampling Subcommittee	Touche Ross & Co. *James K. Loebbecke Arthur Young & Company Richard W. Cutting Peat, Marwick, Mitchell & Co. Robert K. Elliott Coopers & Lybrand Daniel M. Horowitz Haskins & Sells James M. Kusko Ernst & Ernst Richard H. Popeney Arthur Andersen & Co. Robert S. Roussey Price Waterhouse & Co. Walter W. Tuthill, Jr.	8 of 15	53.3%
Stockbrokerage Auditing Subcommittee	Peat, Marwick, Mitchell & Co. *Richard V. McManus Touche Ross & Co. Ronald J. Bach Coopers & Lybrand Harvey J. Bazaar Haskins & Sells Frank J. Borelli Arthur Andersen & Co. Warren A. Essner Arthur Young & Company Michael P. Helmick Ernst & Ernst John J. Kilkeary Price Waterhouse & Co. William U. Westerfield	8 of 12	66.7%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Awards Committee	Arthur Young & Company *Thomas D. Flynn Haskins & Sells Lorin H. Wilson	2 of 7	28.6%
Relations With the Bar Committee	Arthur Andersen & Co. Byrle M. Abbin Price Waterhouse & Co. Frank T. Rea	2 of 7	28.6%
Board of Directors	Haskins & Sells Michael N. Chetkovich Arthur Young & Company Don J. Summa Price Waterhouse & Co. John W. Zick Coopers & Lybrand Philip L. Defliese Ernst & Ernst Richard T. Baker Touche Ross & Co. James E. Seitz	6 of 18	33.3%
Audit Committee	Arthur Young & Company *Don J. Summa	1 of 3	33.3%
FAF Trustee Review Committee	Coopers & Lybrand *Philip L. Defliese Haskins & Sells Michael N. Chetkovich	2 of 7	28.6%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Planning and Finance Committee	Touche Ross & Co. *James E. Seitz Ernst & Ernst Richard T. Baker Coopers & Lybrand Philip L. Defliese Price Waterhouse & Co. John W. Zick	4 of 7	57.1%
Board of Examiners	Haskins & Sells Maurice S. Newman	1 of 9	11.1%
Accounting Practice Subcommittee	Touche Ross & Co. Irwin T. David	1 of 7	14.3%
Accounting Theory Subcommittee	none	0 of 4	-
Auditing Subcommittee	Haskins & Sells Maurice S. Newman	1 of 4	25.0%
Business Law Subcommittee	none	0 of 4	-
Grading Subcommittee	Haskins & Sells Maurice S. Newman	1 of 5	20.0%
Board on Standards for Programs and Schools of Professional Accounting	Arthur Andersen & Co. *Herbert E. Miller Ernst & Ernst Wayne J. Albers Coopers & Lybrand Norman E. Auerbach Peat, Marwick, Mitchell & Co. Charles W. Lamden	4 of 12	33.3%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Computer Services Executive Committee	Arthur Andersen & Co. *Richard J. Guiltinan Arthur Young & Company John C. Broderick Touche Ross & Co. James K. Loebbecke Peat, Marwick, Mitchell & Co. John W. Nuxall Price Waterhouse & Co. Paul B. Woodfin	5 of 10	50.0%
Computer Applications Subcommittee	none	0 of 9	-
Computer Education Subcommittee	Arthur Young & Company *Michael J. Fischetti Peat, Marwick, Mitchell & Co. Robert V. Boos	2 of 8	25.0%
EDP Auditing Standards Subcommittee	Price Waterhouse & Co. A. Bernarr Burke Coopers & Lybrand Martin Jaslow Ernst & Ernst Albert A. Koch Haskins & Sells Richard A. Snyder Touche Ross & Co. Richard D. Webb	5 of 13	38.5%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Remote Computer Services Subcommittee	Haskins & Sells *Dennis C. Fox Touche Ross & Co. Daniel M. Morson Coopers & Lybrand Keith S. Nottage Arthur Young & Company Dana R. Richardson	4 of 8	50.0%
Cost Accounting Standards Board Committee	Arthur Young & Company *Donald J. Hayes Haskins & Sells Gordon [illegible]. Johns Price Waterhouse & Co. James G. Markezin Touche Ross & Co. Aloysius M. Mlot Peat, Marwick, Mitchell & Co. David Neuman Ernst & Ernst William E. Pritts Arthur Andersen & Co. Harold I. Rice Coopers & Lybrand Victor F. St. Thomas	8 of 9	88.9%
Continuing Professional Education Executive Committee	Touche Ross & Co. *Louis A. Werbaneth, Jr. Peat, Marwick, Mitchell & Co. Frank M. McCord	2 of 6	33.3%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Continuing Professional Education Standards Subcommittee	Ernst & Ernst Paul G. Simpson	1 of 8	12.5%
Curriculum Development Subcommittee	none	0 of 15	-
Education Materials Exchange Subcommittee	Peat, Marwick, Mitchell & Co. *Frank M. McCord Price Waterhouse & Co. Donald F. Markstein Haskins & Sells Donald J. McLellan Coopers & Lybrand John J. O'Donnell, Jr. Touche Ross & Co. Ernest J. Pavlock Arthur Young & Company David B. Pearson Ernst & Ernst Arthur P. Weston	7 of 21	33.3%
Program Coordination Subcommittee	none	0 of 16	-
Editorial Advisory Committee--Journal of Accountancy	Arthur Andersen & Co. John C. Amman Haskins & Sells John J. Cooney Peat, Marwick, Mitchell & Co. Daniel D. Donovan Peat, Marwick, Mitchell & Co. Robert K. Elliott Price Waterhouse & Co. John R. Jordan, Jr.	8 of 43	18.6%

Committee	Firm and Representative (* - Chairman of Committee	Big 8/Total Committee Membership	Percent
	Coopers & Lybrand Ronald J. Murray Touche Ross & Co. Gary C. Roats Price Waterhouse & Co. Arthur B. Toan, Jr.		
Editorial Advisory Committee--The Tax Adviser	Coopers & Lybrand William T. Barnes Arthur Andersen & Co. Francis M. Gaffney Haskins & Sells Richard B. Keigley Peat, Marwick, Mitchell & Co. Charles R. Lees Price Waterhouse & Co. William C. Miller Touche Ross & Co. Gerald W. Padwe Ernst & Ernst Robert G. Skinner Arthur Young & Company Don J. Summa	8 of 25	32.0%
Education Executive Committee	Ernst & Ernst Wayne J. Albers Peat, Marwick, Mitchell & Co. Frank M. McCord Arthur Young & Company David B. Pearson	3 of 9	33.3%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Relations With Educational Institutions Subcommittee	Arthur Young & Company Lawrence S. Dunham Coopers & Lybrand William A. Mitchell Ernst & Ernst Richard C. Rantzow	3 of 10	30.0%
Interest In Accounting Careers Subcommittee	Haskins & Sells Robert W. Pivik	1 of 11	9.1%
Personnel Testing Subcommittee	Arthur Young & Company *David B. Pearson	1 of 7	14.3%
Federal Government Executive Committee	Coopers & Lybrand *William T. Barnes Arthur Andersen & Co. Charles A. Bowsher Price Waterhouse & Co. Roscoe L. Egger, Jr. Ernst & Ernst J. Gregory Hickey Peat, Marwick, Mitchell & Co. Thomas L. Holton Touche Ross & Co. Gerald A. Polansky Arthur Young & Company Cornelius E. Tierney Haskins & Sells John F. Utley	8 of 11	72.7%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Federally Assisted Programs Subcommittee	Arthur Andersen & Co.	7 of 14	50.5%
	*Charles A. Bowsher		
	Coopers & Lybrand		
	Robert M. Cockrill		
	Haskins & Sells		
	James S. Dwight, Jr.		
	Peat, Marwick, Mitchell & Co.		
	Bernard F. Gatti		
	Price Waterhouse & Co.		
	Edward J. Haller		
	Arthur Young & Company		
	Cornelius E. Tierney		
	Ernst & Ernst		
	Joseph G. Tonascia		
Financial Institutions Subcommittee	Ernst & Ernst	8 of 12	66.7%
	*J. Gregory Hickey		
	Coopers & Lybrand		
	Thomas H. Asson		
	Touche Ross & Co.		
	James M. Crosser		
	Arthur Andersen & Co.		
	Sam J. DiGiovanni		
	Price Waterhouse & Co.		
	Burton N. Forester		
	Arthur Young & Company		
	Harold L. Russell		
	Haskins & Sells		
	Patrick J. Waide, Jr.		
	Peat, Marwick, Mitchell & Co.		
	Travis L. Wallis		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Relations With GAO Subcommittee	Touche Ross & Co. *Gerald A. Polansky Price Waterhouse & Co. Edward J. Haller Peat, Marwick, Mitchell & Co. Anthony M. Mandolini Coopers & Lybrand James E. Meredith Arthur Andersen & Co. Michael E. Simon Haskins & Sells Francis J. Thomason Ernst & Ernst James F. Zid	7 of 10	70.0%
Regulated Industries Subcommittee	Haskins & Sells *John F. Utley Price Waterhouse & Co. Timothy M. Coffey Coopers & Lybrand Robert W. Egner Ernst & Ernst Thomas L. Jones Peat, Marwick, Mitchell & Co. William G. Morrison, Jr. Touche Ross & Co. Anthony E. Rapp Arthur Young & Company Thomas E. Sinton Arthur Andersen & Co. Richard W. Walker	8 of 11	72.7%

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Federal Taxation Executive Committee	Arthur Andersen & Co. *William C. Penick	7 of 15	46.7%
	Ernst & Ernst Richard L. D'Arcy		
	Arthur Young & Company Samuel M. Frohlich		
	Touche Ross & Co. Eli Gerver		
	Haskins & Sells John W. Gilbert		
	Peat, Marwick, Mitchell & Co. Carl L. Glassberg		
	Price Waterhouse & Co. Dominic A. Tarantino		
Employee Benefits Subcommittee	Peat, Marwick, Mitchell & Co. *Carl L. Glassberg	5 of 9	55.6%
	Price Waterhouse & Co. Michael F. Klein, Jr.		
	Arthur Andersen & Co. Solomon J. Upbin		
	Ernst & Ernst Edward H. Walchli		
	Arthur Young & Company Ernest O. Wood		

Committee	Firm and Representative (* Chairman of Committee)	Big 8/Total Committee Membership	Percent
Financial and Estate Planning Subcommittee	Coopers & Lybrand Herbert A. Huene	1 of 7	14.3%
International Taxation Subcommittee	Arthur Young & Company *Samuel M. Frohlich	6 of 10	60.0%
	Touche Ross & Co. Andre A. Aversa		
	Arthur Andersen & Co. Richard A. Hoefs		
	Coopers & Lybrand Daniel F. Lundy		
	Haskins & Sells Francis C. Oatway		
	Ernst & Ernst Edward D. Ryan		
Responsibilities In Tax Practice Subcommittee	Peat, Marwick, Mitchell & Co. Frank M. Burke, Jr.	1 of 12	8.3%
Scope and Managment of a Tax Practice Subcommittee	Ernst & Ernst *Richard E. D'Arcy	3 of 8	37.5%
	Touche Ross & Co. John J. Jefferies		
	Peat, Marwick, Mitchell & Co. Michael Raddie		

Committee	Firm and Representative (* Chairman of Committee)	Big 8/Total Committee Membership	Percent
Tax Accounting Subcommittee	Ernst & Ernst Herbert J. Lerner	5 of 9	55.6%
	Arthur Andersen & Co. Orville N. Smith		
	Touche Ross & Co. William R. Sutherland		
	Price Waterhouse & Co. James B. Swenson		
	Haskins & Sells Hardy T. Williamson		
Tax Administration Subcommittee	Haskins & Sells *John W. Gilbert	1 of 9	11.1%
Tax Determination Subcommittee	Coopers & Lybrand Carl M. Moser	2 of 9	22.2%
	Price Waterhouse & Co. Leon M. Nad		
Tax Forms Subcommittee	none	0 of 8	-

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Tax Policy Subcommittee	Arthur Young & Company James L. Houghton	4 of 9	44.4%
	Peat, Marwick, Mitchell & Co. Charles R. Lees		
	Coopers & Lybrand Ira H. Shapiro		
	Haskins & Sells Arthur F. Wilkins		
Tax Publications Subcommittee	Touche Ross & Co. *Eli Gerver	1 of 7	14.3%
Taxation of Corporate Distributions and Adjustments Subcommittee	Price Waterhouse & Co. *Dominic A. Tarantino	4 of 9	44.4%
	Arthur Young & Company Robert E. Billings		
	Arthur Andersen & Co. Nicholas E.E. De Stefano		
	Ernst & Ernst Donald C. Opatrny		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Taxation of Special Entities and Industries Subcommittee	Arthur Young & Company William T. Diss	2 of 9	22.2%
	Coppers & Lybrand Francis J. Grey		
General Standards Special Committee	Ernst & Ernst *Ray J. Groves	2 of 6	33.3%
	Arthur Andersen & Co. Robert L. May		
Information Retrieval Committee	Ernst & Ernst *Donald L. Neebes	8 of 13	61.5%
	Price Waterhouse & Co. John W. Bettenhausen		
	Arthur Andersen & Co. Willis A. Leonhardi		
	Arthur Young & Company Rene A. Miller		
	Touche Ross & Co. Dowlan R. Nelson		
	Coopers & Lybrand Felix Pomeranz		
	Haskins & Sells Robert F. Schapperle		
	Peat, Marwick, Mitchell & Co. Thomas E. Vincus		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Insurance Trust Committee	Ernst & Ernst *Harry F. Reiss, Jr.	1 of 3	33.3%
International Practice Executive Committee	Peat, Marwick, Mitchell & Co. Joseph P. Cummings	8 of 18	44.4%
	Price Waterhouse & Co. Robert E. Field		
	Coopers & Lybrand David O. Gillette		
	Arthur Andersen & Co. William D. Hall		
	Ernst & Ernst LeRoy J. Herbert		
	Haskins & Sells Thomas B. Hogan		
	Arthur Young & Company Edwin W. Macrae		
	Touche Ross & Co. Ralph E. Walters		
Relations with Institutes and Conferences Subcommittee	Price Waterhouse & Co. Robert E. Field	4 of 7	57.1%
	Coopers & Lybrand David O. Gillette		
	Arthur Young & Company William C. Ings		
	Peat, Marwick, Mitchell & Co. Daniel Jacobson		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
International Practice Requirements Subcommittee	Ernst & Ernst *LeRoy J. Herbert	5 of 10	50.0%
	Arthur Young & Company Carl G. Francis		
	Arthur Andersen & Co. William D. Hall		
	Touche Ross & Co. James I. Johnston		
	Haskins & Sells James L. McGregor		
echnical Standards Subcommittee (International)	Peat, Marwick, Mitchell & Co. *Joseph P. Cummings	5 of 10	50.0%
	Price Waterhouse & Co. Robert Hampton, III		
	Arthur Andersen & Co. William P. Hauworth, II		
	Coopers & Lybrand Ronald J. Murray		
	Touche Ross & Co. Ralph E. Walters		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Accountants International Study Group	Arthur Young & Company *Edwin W. Macrae	2 of 3	66.7%
	Arthur Andersen & Co. William P. Hauworth, II		
Confederation of Asian and Pacific Accountants	Touche Ross & Co. Ralph E. Walters	1 of 1	100.0%
Inter-American Accounting Association	Arthur Young & Company *William C. Ings	1 of 3	33.3%
International Accounting Standards Committee	Peat, Marwick, Mitchell & Co. Joseph P. Cummings	1 of 2	50.0%
International Coordination Committee for the Accountancy Profession	Haskins & Sells Michael N. Chetkovich	1 of 1	100.0%
International Qualifications Appraisal Committee	Touche Ross & Co. *Frederic L. Blank	4 of 7	57.1%
	Coopers & Lybrand J. Kenneth S. Arthur		
	Arthur Andersen & Co. James A. Campbell		
	Peat, Marwick, Mitchell & Co. David W. Thompson		
Investments Committee	none	0 of 3	-

Committee	Firm and Representative (* Chairman of Committee)	Big 8/Total Committee Membership	Percent
National Review Board	Arthur Young & Company Donald T. Burns	9 of 35	25.7%
	Price Waterhouse & Co. Gordon W. Tasker		
	Haskins & Sells Robert F. Dickey		
	Arthur Young & Company John L. Harvey, Jr.		
	Arthur Young & Company Jerome A. Schine		
	Ernst & Ernst R. Neal Fulk		
	Peat, Marwick, Mitchell & Co. Howard E. Hansen		
	Haskins & Sells Ralph J. Kliber		
	Touche Ross & Co. E. Palmer Tang		
Regional Trial Boards	Arthur Andersen & Co. Donald E. Hietter	9 of 24	37.5%
	Coopers & Lybrand E. William Parker		
	Arthur Young & Company Robert I. Winslow		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
	Coopers & Lybrand Harry E. Ward		
	Ernst & Ernst William J. Willy		
	Price Waterhouse & Co. Douglas T. Smith		
	Touche Ross & Co. Norman Cogliati		
	Ernst & Ernst Robert J. Seider		
	Arthur Andersen & Co. Robert L. May		
Local Firm Quality Review Committee	none	0 of 10	-
Management Advisory Services Executive Committee	Peat, Marwick, Mitchell & Co. *Stanley R. Klion	8 of 15	53.3%
	Arthur Andersen & Co. Joseph F. Carrico		
	Price Waterhouse & Co. Henry Gunders		
	Ernst & Ernst Donald C. Jensen		
	Haskins & Sells Robert D. Niemeyer		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/ Total Committee Membership	Percent
	Coopers & Lybrand Joseph V. O'Donnell		
	Touche Ross & Co. Max F. Sporer		
	Arthur Young & Company Virgil E. Wenger		
MAS Development Subcommittee	Ernst & Ernst Francis H. Beam	4 of 10	40.0%
	Peat, Marwick, Mitchell & Co. John J. Doyle		
	Haskins & Sells William W. Gerecke		
	Arthur Andersen & Co. H. George Trentin		
MAS EDP Consulting Subcommittee	Touche Ross & Co. William Atkins	5 of 12	41.7%
	Ernst & Ernst Joseph A. Celia		
	Arthur Young & Company Vincent P. Hussian, Jr.		
	Haskins & Sells Donald L. Morchower		
	Peat, Marwick, Mitchell & Co. George H. Rittershach		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
MAS Education and Training Subcommittee	Ernst & Ernst E. Leonard Arnoff	5 of 14	35.7%
	Price Waterhouse & Co. Howard G. Johnson		
	Arthur Young & Company Glenn H. Van Doren		
	Touche Ross & Co. Alvin E. Wanthal		
	Arthur Andersen & Co. Arthur E. Welby		
MAS Small Business Consulting Subcommittee	none	0 of 12	-
MAS Technical Standards Subcommittee	Arthur Young & Company *Virgil W. Wenger	5 of 12	41.7%
	Touche Ross & Co. David L. Fleisher		
	Peat, Marwick, Mitchell & Co. George J. Krahm		
	Haskins & Sells Robert D. Niemeyer		
	Price Waterhouse & Co. David C. Samuelson		
Management Of An Accounting Practice Committee	none	0 of 22	

Committee	Firm and Representative (* Chairman of Committee)	Big 8/Total Committee Membership	Percent
Minority Recruitment And Equal Opportunity Committee	Coopers & Lybrand Martin Abrahams	5 of 20	25.0%
	Arthur Andersen & Co. Frances Garcia		
	Price Waterhouse & Co. John L. Kielty		
	Arthur Young & Company John J. Schornack		
	Touche Ross & Co. Arthur F. Weinbach		
Nominations Committee	Coopers & Lybrand *Philip L. Defliese	3 of 7	42.9%
	Ernst & Ernst Richard E. D'Arcy		
	Arthur Young & Company John L. Harvey		
Practice Review Committee	Peat, Marwick, Mitchell & Co. George J. Frey	4 of 10	40.0%
	Coopers & Lybrand John W. Kennedy, Jr.		
	Ernst & Ernst James H. Murphy		
	Haskins & Sells Charles A. Walworth		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Professional Ethics Executive Committee	Coopers & Lybrand H. Barry Burris	5 of 10	50.0%
	Arthur Andersen & Co. Wilbur S. Duncan		
	Touche Ross & Co. A. Clayton Ostlund		
	Haskins & Sells Philip J. Sandmaier, Jr.		
	Ernst & Ernst Clark K. Sprinkle		
Behavioral Standards Subcommittee	Touche Ross & Co. *A. Clayton Ostlund	3 of 7	42.9%
	Coopers & Lybrand William J. McClellan		
	Ernst & Ernst Clark K. Sprinkle		
Independence Subcommittee	Arthur Andersen & Co. *Wilbur S. Duncan	2 of 7	28.6%
	Haskins & Sells Philip J. Sandmaier, Jr.		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Technical Standards Subcommittee	Coopers & Lybrand *H. Barry Burris	4 of 7	57.1%
	Ernst & Ernst Robert C. Holsen		
	Arthur Andersen & Co. Herbert E. Miller		
	Peat, Marwick, Mitchell & Co. Irwin F. Sentilles, II		
Retirement Committee	none	0 of 4	-
SEC Regulations Committee	Peat, Marwick, Mitchell & Co. *Thomas L. Holton	8 of 18	44.4%
	Haskins & Sells Delford W. Edens		
	Arthur Andersen & Co. Robert Mednick		
	Ernst & Ernst Robert D. Neary		
	Arthur Young & Company John W. Nicholson		
	Touche Ross & Co. Morton Poloway		
	Coopers & Lybrand Fred S. Spindel		
	Price Waterhouse & Co. W. Arthur Stimpson		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Self-Regulation Special Committee	Peat, Marwick, Mitchell & Co. Walter E. Hanson	2 of 8	25.0%
	Arthur Young & Company William S. Kanaga		
Small Business Development Committee	Arthur Andersen & Co. Alfred W. Bertoline	3 of 12	25.0%
	Peat, Marwick, Mitchell & Co. Chet R. Cavaliere		
	Touche Ross & Co. Frederick A. Fuchs		
Specialization Special Committee	Ernst & Ernst Robert G. Skinner	2 of 10	20.0%
	Arthur Andersen & Co. H. George Trentin		
State Legislation Committee	Peat, Marwick, Mitchell & Co. Gordon W. Paul	2 of 10	20.0%
	Touche Ross & Co. Warren L. Ress		
Legislative Action Subcommittee	Peat, Marwick, Mitchell & Co. Gordon W. Paul	2 of 11	18.2%
	Touche Ross & Co. Warren L. Ress		

Committee	Firm and Representative (* - Chairman of Committee)	Big 8/Total Committee Membership	Percent
Legislative Policy Subcommittee	Arthur Young & Company David W. Bremner	4 of 10	40.0%
	Arthur Andersen & Co. Donald E. Hietter		
	Ernst & Ernst Frank E. Outhier		
	Touche Ross & Co. Russel F. Viehweg		
State Legislation Area Subcommittees I-X	Touche Ross & Co. Warren L. Ress	1 of 10	10.0%
Relations With State Societies Executive Committee	Coopers & Lybrand J. Paul Finnegan	2 of 9	22.2%
	Arthur Young & Company William A. Jacoby		
State Society Pension Plan Committee	none	0 of 3	-

APPENDIX F
THE NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY

ABRAHAM RIBICOFF, CONN., CHAIRMAN

JOHN L. MC CLELLAN, ARK.
HENRY M. JACKSON, WASH.
EDMUND S. MUSKIE, MAINE
LEE METCALF, MONT.
JAMES B. ALLEN, ALA.
LAWTON CHILES, FLA.
SAM NUNN, GA.
JOHN GLENN, OHIO

CHARLES H. PERCY, ILL.
JACOB K. JAVITS, N.Y.
WILLIAM V. ROTH, JR., DEL.
BILL BROCK, TENN.
LOWELL P. WEICKER, JR., CONN.

RICHARD A. WEGMAN
CHIEF COUNSEL AND STAFF DIRECTOR

SUBCOMMITTEE:
LEE METCALF, MONT., CHAIRMAN

JOHN L. MC CLELLAN, ARK.
EDMUND S. MUSKIE, MAINE
SAM NUNN, GA.
JOHN GLENN, OHIO

BILL BROCK, TENN.
CHARLES H. PERCY, ILL.
LOWELL P. WEICKER, JR., CONN.

VIC REINEMER, STAFF DIRECTOR
E. WINSLOW TURNER, CHIEF COUNSEL
161 RUSSELL BUILDING

(202) 224-1474

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

30 March 1976

National Association of State
Boards of Accountancy
1211 Avenue of the Americas
New York, New York 10036

Dear Gentlemen:

Much attention has recently been focused on the accounting profession and rules and regulations relating thereto. Financial decisions and public policies are dependent on principles and procedures used by accountants who determine the propriety and fairness of financial data and other information which are required by law to be disclosed.

This subcommittee is charged with insuring that accounting practices used or approved by agencies of the Federal government are fair, accurate, and useful to those persons who must rely upon them. In particular, this subcommittee is concerned with the roles played by the General Accounting Office, the Securities and Exchange Commission, and the Cost Accounting Standards Board in promoting reliable accounting practices.

To a large degree, agencies of the Federal government have relied on the findings and practices of public accountants in performing the duties assigned to them by Congress.

State Boards for Public Accountancy license certified public accountants and establish rules regulating such licenses. In evaluating Federal accounting practices, it would be helpful to the subcommittee to have some information regarding state boards and your organization. A brief questionnaire seeking such information is enclosed.

Your cooperation and prompt reply would be greatly appreciated.

Very truly yours,

Original signed by
Senator Lee Metcalf

nasba

NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY

1211 AVENUE OF THE AMERICAS, NEW YORK, NEW YORK 10036

Office of the President

W. DOUGLAS SPRAGUE

120 East 56th Street

New York, New York 10022

April 6, 1976

The Honorable Lee Metcalf
United States Senate
Washington, D. C. 20510

My dear Senator:

On behalf of the National Association of State Boards of Accountancy, it is my pleasure to respond to the questionnaire enclosed with your letter of March 30.

1. The state boards of accountancy in all 50 states, the District of Columbia, Guam, Puerto Rico and the Virgin Islands issue licenses to certified public accountants.

2. A list of the names and addresses of the state boards of accountancy of the United States is enclosed.

3. The bylaws of the National Association of State Boards of Accountancy appear on pages 12-18 of the enclosed copy of NASBA's 1974-1975 Annual Report. NASBA does not have a Code of Ethics. State boards of accountancy operate under codes of ethics applicable to state regulatory agencies. They also promulgate codes of ethics in accordance with the statutory authority.

4. Copies of NASBA's Annual Reports for the last three years are enclosed. Prior to 1973, NASBA did not publish Annual Reports. However, the minutes and proceedings of NASBA's Annual Meetings are available on request.

We might point out that the Accountancy Law Reporter, published by Commerce Clearing House, Inc., contains the accountancy statutes, state board regulations and codes of ethics of all jurisdictions. This publication might be a useful reference for your committee.

If you have any questions, or if we can be of any other assistance, please let us know.

Sincerely yours,

W. Douglas Sprague

W. Douglas Sprague
President

WDS:ac

NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY

THE STATE BOARDS OF ACCOUNTANCY OF THE UNITED STATES

ALABAMA STATE BOARD OF PUBLIC ACCOUNTANCY
1103 So. Perry St.
Montgomery, Alabama 36104
Attn: Joseph G. Robertson
Executive Director
Telephone: (205) 834-7650

ALASKA STATE BOARD OF PUBLIC ACCOUNTANCY
Department of Commerce
Division of Occupational Licensing
Pouch D
Juneau, Alaska 99811
Attn: Mrs. Pat Temple
Telephone: (907) 465-2548

ARKANSAS STATE BOARD OF ACCOUNTANCY
980 Plaza West
Little Rock, Arkansas 72205
Attn: William Yarbrough
Executive Director
Telephone: (501) 371-1520

ARIZONA STATE BOARD OF ACCOUNTANCY
1645 West Jefferson Street
Phoenix, Arizona 85007
Attn: Mrs. Alta F. Cushing
Administrative Assistant
Telephone: (602) 271-4134

CALIFORNIA STATE BOARD OF ACCOUNTANCY
1021 O Street, Room A-596
Sacramento, California 95814
Attn: Donald O. Otten
Executive Secretary
Telephone: (916) 445-5347

COLORADO STATE BOARD OF ACCOUNTANCY
117 State Services Building
Denver, Colorado 80203
Attn: Mrs. Evelyn Brundage
Executive Secretary
Telephone: (303) 892-2869

CONNECTICUT STATE BOARD OF ACCOUNTANCY
11 Asylum Street
Hartford, Connecticut 06103
Attn: William S. De Mayo
Treasurer
Telephone: (203) 247-6106

DELAWARE STATE BOARD OF ACCOUNTANCY
P.O. Box 121
Newark, Delaware 19711
Attn: William Markell
Administrative Secretary
Telephone: (302) 738-2554

D.C. BOARD OF ACCOUNTANCY
Occupational and Professional Licensing Div.
614 H Street, N.W., Room 109
Washington, D.C. 20001
Attn: Harold J. Bobys, CPA
Secretary
Telephone: (202) 629-4543

FLORIDA STATE BOARD OF ACCOUNTANCY
P.O. Box 13475 University Station
Gainesville, Florida 32604
Attn: Douglas H. Thompson, Jr.
Executive Director
Telephone: (904) 372-2032

GEORGIA STATE BOARD OF ACCOUNTANCY
166 Pryor Street, S.W.
Atlanta, Georgia 30303
Attn: James E. Skine
Joint-Secretary
Telephone: (404) 656-3941

GUAM TERR. BOARD OF PUBLIC ACCOUNTANCY
P.O. Box P
Agana, Guam 96910
Attn: Allen A. Pickens
Chairman

HAWAII BOARD OF ACCOUNTANCY
Department of Regulatory Agencies
P.O. Box 3469
Honolulu, Hawaii 96801
Attn: Herbert Chun
Executive Secretary

IDAHO STATE BOARD OF ACCOUNTANCY
P.O. Box 2896
Boise, Idaho 83701
Attn: Mrs. Jeanette B. Drury
Executive Secretary
Telephone: (208) 384-2490

ILLINOIS
Committee on Accountancy
408 Metallurgy & Mining Bldg.
University of Illinois
Urbana, Illinois 61801
Attn: E. J. Smith
Secretary
Telephone: (217) 333-1565

Committee on Public Accountancy Comm.
Ronald E. Stackler
Director
Department of Reg. & Educ.
628 East Adams St.
Springfield, Illinois 62706
Telephone: (217) 782-4624

INDIANA STATE BOARD OF PUBLIC ACCOUNTANCY
912 State Office Building
Indianapolis, Indiana 46204
Attn: Charles W. Stout
Secretary
Telephone: (317) 633-6619

IOWA BOARD OF ACCOUNTANCY
627 Insurance Exchange Building
Des Moines, Iowa 50309
Attn: Mrs. Thelma Crittenden
Executive Secretary
Telephone: (515) 288-8319

KANSAS BOARD OF ACCOUNTANCY
325-K First National Bank Tower
Topeka, Kansas 66603
Attn: Mrs. Glenda Sherman
Secretary
Telephone: (913) 357-4113

KENTUCKY STATE BOARD OF ACCOUNTANCY
310 West Liberty
Louisville, Kentucky 40202
Attn: Bernard W. Gratzer
Executive Secretary
Telephone: (502) 589-9239

STATE BOARD OF CPAs OF LOUISIANA
1109 Masonic Temple Building
333 St. Charles Avenue
New Orleans, Louisiana 70130
Attn: Mrs. Lydia F. Parek
Executive Secretary
Telephone: (504) 522-4940

MAINE BOARD OF ACCOUNTANCY
84 Harlow Street
Bangor, Maine 04401
Attn: Lawrence E. Parker, Jr.
Secretary
Telephone: (207) 942-6702

MARYLAND STATE BOARD OF PUBLIC ACCOUNTANCY
One South Calvert Building, Eighth Floor
Baltimore, Maryland 21202
Attn: Mrs. Elizabeth B. Knight
Administrative Secretary
Telephone: (301) 383-2134

MASSACHUSETTS BOARD OF PUBLIC ACCOUNTANCY
100 Cambridge Street, Room 1524
Boston, Massachusetts 02202
Attn: Rocco J. Antonelli
Executive Secretary
Telephone: (617) 727-3078

MICHIGAN BOARD OF ACCOUNTANCY
Department of Licensing & Regulation
1116 South Washington Avenue
Lansing, Michigan 48926
Attn: Wayne D. Cunningham
Administrative Secretary
Telephone: (517) 373-0682

MINNESOTA STATE BOARD OF ACCOUNTANCY
708 Wesley Temple Building
Minneapolis, Minnesota 55403
Attn: Robert A. Unzen
Secretary-Treasurer
Telephone: (612) 339-2781

MISSISSIPPI STATE BOARD OF PUBLIC ACCOUNTANCY
1855 Lakeland Drive
P. O. Box 4923
Jackson, Mississippi 39216
Attn: John W. Morgan
Secretary
Telephone: (601) 981-3933

MISSOURI STATE BOARD OF ACCOUNTANCY
P.O. Box 613
Jefferson City, Missiouri 65101
Attn: Ms. Ruth Calhoun
Executive Assistant
Telephone: (314) 751-2334

MONTANA STATE BOARD OF PUBLIC ACCOUNTANCY
Lalonde Building, Room 7
Helena, Montana 59601
Attn: Joan DeBorde
Administrative Assistant
Telephone: (406) 449-3737

NEBRASKA STATE BOARD OF PUBLIC ACCOUNTANCY
State Capitol Building, Room 2301
P. O. Box 94725
Lincoln, Nebraska 68509
Att: Ray A. C. Johnson
Secretary
Telephone: (402) 471-2111 Ext. 26

NEVADA STATE BOARD OF ACCOUNTANCY
290 South Arlington Avenue
Reno, Nevada 89501
Attn: Mrs. Marguerite M. Callahan
Executive Secretary
Telephone: (702) 786-0231

NEW HAMPSHIRE BOARD OF ACCOUNTANCY
One Tremont Street
Concord, New Hampshire 03301
Attn: Norman C. Batchelder
Secretary-Treasurer
Telephone: (603) 673-6500

NEW JERSEY BOARD OF CPAs
1100 Raymond Boulevard, Room 420
Newark, New Jersey 07102
Attn: Mrs. Mary R. Lannon
Secretary
Telephone: (201) 648-3240

NEW MEXICO STATE BOARD OF PUBLIC ACCOUNTANCY
6101 Marble, N.E., Suites 7 & 8
Albuquerque, New Mexico 87110
Attn: L.A.B. Parker
Executive Secretary
Telephone: (505) 265-7709

NEW YORK STATE BOARD FOR PUBLIC ACCOUNTANCY
State Education Department
Room 1839, Twin Tower Building
99 Washington Avenue
Albany, New York 12210
Attn: Robert G. Allyn
Executive Secretary
Telephone: (518) 474-3836

NORTH CAROLINA STATE BOARD OF CPA EXAMINERS
P.O. Box 2248
209 Lennox Building
Chapel Hill, North Carolina 27514
Attn: Miss Katherine D. Guthrie
Executive Director
Telephone: (919) 968-4449

NORTH DAKOTA STATE BOARD OF ACCOUNTANCY
Box 8104 University Station
Grand Forks, North Dakota 58201
Attn: R.D. Koppenhaver
Secretary-Treasurer
Telephone: (701) 777-2923

ACCOUNTANCY BOARD OF OHIO
180 East Broad Street, Suite 414
Columbus, Ohio 43215
Attn: Dan Joseph, Jr.
Director
Telephone: (614) 466-4135

OKLAHOMA STATE BOARD OF PUBLIC ACCOUNTANCY
265 West Court
4545 Lincoln Boulevard
Oklahoma City, Oklahoma 73105
Attn: Mrs. Diana Collinsworth
Executive Assistant
Telephone: (405) 521-2397

OREGON BOARD OF ACCOUNTANCY
Labor & Industries Bldg., 4th Floor
Salem, Oregon 97310
Attn: Mrs. Helen Garrett
Administrator
Telephone: (503) 378-4181

PENNSYLVANIA STATE BOARD OF EXAMINERS OF PUBLIC ACCOUNTANTS
279 Boas Street, Room 301
Harrisburg, Pennsylvania 17120
Attn: Mark Hubbard
Corres. Secretary
Telephone: (717) 787-3024

PUERTO RICO BOARD OF ACCOUNTANCY
Box 3271
San Juan, Puerto Rico 00904
Attn: Justino Valles
Administrative Officer
Telephone: (809) 725-0142

RHODE ISLAND BOARD OF ACCOUNTANCY
1429 Warwick Avenue
Warwick, Rhode Island 02888
Attn: Howard J. Swanson
Secretary
Telephone: (401) 463-8900

SOUTH CAROLINA BOARD OF ACCOUNTANCY
P.O. Box 11376
Columbia, South Carolina 29211
Attn: John S. Herin
Administrator
Telephone: (803) 777-3178

SOUTH DAKOTA BOARD OF ACCOUNTANCY
141 North Main Avenue, Suite 308
Sioux Falls, South Dakota 57102
Attn: John E. Page
Executive Director
Telephone: (605) 336-1858

TENNESSEE STATE BOARD OF ACCOUNTANCY
Capitol Hill Bldg., Room 500
7th & Union
Nashville, Tennessee 37219
Attn: Clyde R. Watson
Secretary
Telephone: (615) 741-2550

TEXAS STATE BOARD OF PUBLIC ACCOUNTANCY
940 American Bank Tower
221 West Sixth Street
Austin, Texas 78701
Attn: Mrs. Pauline Thomas
Administrative Director
Telephone: (512) 476-6971

UTAH COMMITTEE FOR PUBLIC ACCOUNTANCY
330 East Fourth South Street
Salt Lake City, Utah 84111
Attn: Floy W. McGinn
Director
Telephone: (801) 328-5711

VERMONT STATE BOARD OF ACCOUNTANCY
Boucher & Marrow
Two Linden Street
Brattleboro, Vermont 05301
Attn: James C. Plumpton
Secretary
Telephone: (802) 257-0551

VIRGINIA STATE BOARD OF ACCOUNTANCY
Department of Professional and
Occupational Regulation, 2 So. Ninth St.
P.O. Box 1-X
Richmond, Virginia 23202
Attn: Mrs. Ruth J. Herrink
Director
Telephone: (804) 786-2161

VIRGIN ISLANDS BOARD OF PUBLIC ACCOUNTANCY
Box 511, Charlotte Amalie
St. Thomas, Virgin Islands 00801
Attn: Ezra A. Gomez
Secretary

WASHINGTON STATE BOARD OF ACCOUNTANCY
210 East Union, Suite H
Olympia, Washington 98504
Attn: Mrs. Helen Z. Peterson
Administrative Assistant
Telephone: (206) 753-2585

WEST VIRGINIA BOARD OF ACCOUNTANCY
1800 Washington Street East, Room 463
Charleston, West Virginia 25305
Attn: Willard H. Erwin, Jr.
Secretary
Telephone: (304) 348-3557

WISCONSIN ACCOUNTING EXAMINING BOARD
201 East Washington Avenue
Madison, Wisconsin 53702
Attn: James B. Bower
Secretary
Telephone: (608) 266-3020

WYOMING STATE BOARD OF ACCOUNTANCY
Capitol Complex
200 W. 25th Street
Cheyenne, Wyoming 82002
Attn: Mrs. R. Marion Davis
Administrative Assistant
Telephone: (307) 777-7551

Annual Report | 1974-1975

A YEAR OF DECISION

"In recent years there has been a growing tendency for licensing officials to form groups and associations with their counterparts in other states in order to share ideas and work toward common goals. . . . If these groups are to accomplish anything significant, they need more funds with which to operate, but funds are not likely to be forthcoming from individual state boards or from state licensing agencies until worthwhile action programs are developed."*

National Association of State Boards of Accountancy

NATIONAL ASSOCIATION OF
STATE BOARDS OF ACCOUNTANCY

BOARD OF DIRECTORS

1974-1975

Officers

President — Roger R. Cloutier (Iowa)
President-Elect — W. Douglas Sprague (New York)
Vice President — Louis W. Matusiak (California)
Vice President — Gordon W. Paul (New Mexico)
Treasurer — Lloyd J. Weaver (Texas)
Secretary — I. Allen Brown (Washington)

Executive Director — William H. Van Rensselaer

Directors

Immediate Past President — Andrew P. Marincovich (California)
Director-at-Large — Gordon R. Jacobson (Oregon)
Director-at-Large — Carl E. Jonson (Virginia)
Director-at-Large — Wilbur H. Stevens (Colorado)

Regional Directors

Northeastern — Edward Higbee (Massachusetts)
Middle Atlantic — Robert Bernstein (District of Columbia)
Southern — James E. Bates (Georgia)
Great Lakes — Gerald C. Schroeder (Michigan)
Central — Clayton C. McMurray (Kansas)
Mountain — Daniel Goldfarb (Nevada)
Pacific — Anthony Guntermann (California)

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*Cover quotation from "Occupational Licensing: Practices and Policies," by Benjamin Shimberg, Barbara F. Esser and Daniel H. Kruger. Public Affairs Press, Washington, D.C., 1973.

From the President — 1974-1975

When I took office in October 1974, I noted that during the previous few years NASBA had gained both direction and momentum, and was on the threshold of a new era of service to state boards. I appealed to all state boards to help NASBA cross that threshold by working with their counterparts in other states on the development of useful programs and services for state boards.

Today, I am pleased to say that NASBA has crossed that threshold. As the accompanying report indicates, NASBA has refined its organizational structure, clarified its purpose, expanded its resources, and embarked on a new program of service to state boards.

This progress has been made possible by the dedicated efforts of NASBA's officers, directors, committees, executive director and staff — but even moreso by the active participation and guidance of the state boards of accountancy. Every state board of accountancy in the United States, without exception, has participated in NASBA's activities and has helped formulate NASBA's new program. This commitment to excellence augurs well for the future of NASBA and for the public it seeks to serve.

Roger R. Cloutier

Roger R. Cloutier
President 1974-1975

Annual Report 1974-1975

The year 1974-1975 was a year of decision for NASBA. It was a year in which the state boards of accountancy of the United States addressed themselves to the rapid change in public expectations and to the need for new programs to assist state boards in discharging their public responsibilities.

The year began with the publication of "The Future Course of NASBA," the final report of the Committee on Objectives, Structure and Finance. This report was the product of an intensive two-year study conducted by a specially selected and carefully balanced committee of state board members and other professional leaders. The report recommended that NASBA adopt a new organizational structure, establish a new method of financing, and implement a new series of programs, publications and services. The report concluded as follows:

"The committee strongly and unanimously recommends the form of membership and organization structure for NASBA that is set forth in the proposed revision of the bylaws. In addition, the committee believes that it has charted a course for the development of constructive programs by NASBA which, if properly implemented, will provide the state boards of accountancy with useful and needed tools for carrying out the responsibilities imposed upon them by the various statutes. The committee hopes the suggested programs and services by NASBA will commend themselves to the judgment of the state boards of accountancy as a pathway toward more effective regulation of the accounting profession in fulfillment of the public interest."

The committee's report was approved by NASBA's Board of Directors and distributed to all state board members in November 1974. The report served as a blueprint for all NASBA's activities during the year, and was the subject of discussion at all NASBA's meetings. As a result, significant issues were brought forward, important decisions were made, and new programs and services were initiated. These accomplishments, which are summarized on the following pages, were brought about by the nation's state boards of accountancy, whose dedicated members and staff devote countless hours and untold energies to improve the regulation of the profession.

NASBA's Organizational Structure

As noted by the Committee on Objectives, Structure and Finance, "state board members are well aware of the growing complexities and increasing difficulties they face in discharging their responsibilities effectively. . . . More than ever before, state boards of accountancy recognize the need for an organization that will bring them together with their counterparts in other states and that will provide them with services to help them discharge their responsibilities more efficiently and effectively.

"At the same time," the committee pointed out, "state boards of accountancy recognize that they are independent agencies of the sovereign states. They are beholden only to the authority in each state that created or appointed them, and they may not delegate their responsibility. They cannot be a part of any organization that attempts to influence their independence or infringe on their prerogatives.

"Therefore," the committee concluded, "what the state boards want, and what the state boards need, is an organization over which the state boards have control but which has no control over the state boards."

This philosophy was embodied in a complete revision of NASBA's bylaws, which was adopted by the state boards at NASBA's 68th Annual Meeting in San Antonio, on October 10, 1975. The new bylaws now make it clear that NASBA, as its name implies, is an organization of state boards, not of individuals, and that NASBA is governed by the state boards. NASBA's Annual Meeting is now a "General Assembly" of the state boards with the members of state boards serving as delegates, and with each state board having one vote. The Board of Directors is elected by and is an agent of the state boards. Its function is to implement and administer the policies and programs established by the state boards and to provide advice and counsel to the state boards.

All of this represents a significant change in NASBA's organizational structure which may not be noticeable at first glance. Of particular importance, the new structure will encourage all state board members to become more involved in governing NASBA, because they will participate in determining how their board votes on matters brought before the "General Assembly." Of equal importance, the actions of NASBA will represent clearly the views of the state boards on particular issues.

NASBA's Purpose

While the newly revised bylaws represent a significant change in NASBA's organizational structure, they do not change NASBA's basic purpose. As simplified and restated in the new bylaws, NASBA's purpose is "to provide an organization through which the state boards of accountancy of the United States may counsel together and obtain such services as they may desire to assist them in discharging their responsibilities for the administration of public accountancy laws and for the protection of the public interest as it is affected by the practice of public accountancy." Ever since the members of the New Jersey State Board of Public Accountants invited their counterparts in other states to meet in Atlantic City in October 1908 "to confer in regard to matters of mutual interest," the state boards of accountancy have recognized the need for such an organization, and every year since then the state boards have worked together in an effort to make that organization more effective.

NASBA's Resources

Until 1964, all of NASBA's programs and services were conceived, developed and administered by volunteers whose duties as part-time state board members and full-time practitioners left little time to devote to NASBA. In spite of its limited resources, however, much was accomplished. NASBA's Board of Directors and committees worked closely with the AICPA and other professional societies in promoting the adoption of the Uniform CPA Examination, uniform education and experience requirements, uniform codes of ethics, and uniform accountancy laws and state board regulations. A measure of consistency was achieved which was the envy of other professions, but the state boards were not satisfied with the pace of progress.

Therefore, at NASBA's Annual Meeting in 1964, the state boards of accountancy voted to increase their dues in order to establish a headquarters office and engage a part-time executive secretary. Five years later they decided that part-time assistance was not enough and that full-time direction was needed to launch an effective program. NASBA's Board of Directors was convinced that with the services of a full-time executive director, a self-sustaining program of service to state boards could be developed within another five years. The Board searched for an executive director and for a source of funds to support his office. In 1972, with the concurrence of the state boards, the Board hired a full-time executive director and agreed to seek contributions from accounting firms and practitioners for a period of five years to finance his office.

As noted in the OSF Committee's report, "The response to this fund raising program has been most gratifying. It has demonstrated the profession's interest in improving the effectiveness of state regulation, and it has given NASBA an opportunity to discover its full potential." At the same time, the report said, "The state boards have recognized that if NASBA is to be controlled by the state boards, then NASBA should be financed by the state boards." The report pointed out that it had been ten years since the state boards last increased their dues, and that the increase in NASBA's operating costs, the improvement of NASBA's programs, and the expansion of NASBA's services clearly justified an increase in NASBA's dues and the imposition of fees for NASBA's services.

The report recommended that the Board of Directors proceed promptly to develop a revised dues schedule for presentation to and approval by the state boards, and to establish such fees as it deemed appropriate for NASBA's services. The report also recommended that to the extent possible NASBA's basic financing in the future should be derived from dues paid by state boards and from fees charged for NASBA's services.

At NASBA's Annual Meeting in October 1975. the state boards of accountancy approved a revised dues schedule which will more than double NASBA's dues income from state boards. In addition, a new dues category was established for Associates of NASBA. Heretofore, all former members of state boards were automatically associate members of NASBA and were retained indefinitely on NASBA's mailing list at no charge. Under the new bylaws, only those former members of state boards who wish to pay the dues established by the Board of Directors and approved by the state boards of accountancy will be Associates of NASBA. Associates will receive NASBA's regular newsletter and other appropriate communications. They will have the privilege of the floor at all NASBA's meetings

and they will be eligible for service as officers, directors and members of committees within the limitations set forth in the new bylaws.

The amount of dues for Associates, which was established by the Board of Directors and approved by the state boards of accountancy, will be $25 per year effective with the fiscal year ending July 31, 1976. All former members of state boards will be encouraged to support NASBA's activities, and to participate in NASBA's programs by becoming Associates of NASBA under the provisions of the new bylaws.

A number of other income producing programs have been initiated and are discussed elsewhere in this report. When all of these programs have been implemented, NASBA should be able to operate on a self-sustaining basis. In the meantime, NASBA's five-year program of short-term financing will be continued. During the first three years of this program, 105 accounting firms and practitioners have contributed more than $130,000 to help support NASBA's activities. This report, it is hoped, will demonstrate that these funds have been well invested, and will encourage others to assist NASBA in its efforts to become a self-sustaining organization within the next two years.

NASBA's Programs, Publications and Services

As pointed out in the report of the Committee on Objectives, Structure and Finance, the principal purpose of NASBA and the primary responsibility of the Board of Directors is to provide the most effective means for state boards of accountancy to counsel together and to exchange information on matters of mutual interest. During the past year, special attention has been focused on expanding and improving NASBA's Annual and Regional Meetings, and on developing specialized conferences and seminars on topics of immediate concern to state boards. Attention also has been focused on expanding and improving NASBA's publications and other services, which keep information flowing between meetings and accessable when needed. NASBA's efforts in this area and the activities of NASBA's committees are described below.

Model Rules and Regulations

A major project initiated this year was the preparation of a document that will set forth the rules and regulations which are recommended for adoption by the state boards to achieve greater efficiency and consistency in the administration of state

accountancy laws. A special task force under the chairmanship of Angus H. Cockrell, Jr. (Texas) prepared the initial draft which was distributed to the chairmen of NASBA's four major committees in May. Responses from each committee were incorporated in a revised draft which was submitted to NASBA's Board of Directors in October. After review by the Board, it is expected that an exposure draft will be distributed to the state boards for consideration.

Qualifying Education and Experience

NASBA's Committee on Accounting Education and Experience, under the chairmanship of Wilbur H. Stevens (Colorado), maintained liaison with, and through its representatives participated in the deliberations of, the American Institute's Board on Standards for Programs and Schools of Professional Accounting. As an outgrowth of the Board's work, consideration is being given to the desirability of organizing an agency to accredit programs and schools of professional accounting. Since accreditation by such an agency would need to be acceptable to the state boards of accountancy, the participation of state boards in the accreditation process must also be considered. The question of whether or not and the extent to which state boards should participate in this process will receive careful attention during the coming year.

The education committee also reviewed and commented on the first draft of NASBA's Model Rules and Regulations as they relate to qualifying education and experience. In doing so, it became apparent to the committee that the evaluation of public accounting experience and "its equivalent" has become one of the most difficult and time consuming responsibilities of state boards. For this reason, it was recommended that NASBA sponsor a "National Conference on Qualifying Experience" during the coming year. This recommendation was approved by the Board of Directors, and planning for the conference is now under way.

Continuing Education

More than 60 representatives from 30 states gathered in Denver, Colorado in May to confer on the present status and future course of continuing education requirements for public accounting practitioners. Sponsored by NASBA's Committee on Continuing Education, under the chairmanship of I. Allen Brown (Washington), the "Conference on Continuing Education Requirements" brought together representatives from all 18 states which have adopted regulatory continuing educa-

tion requirements. Also represented were those states which are seeking regulatory requirements and other states which have adopted voluntary continuing education programs.

Conference participants reviewed and reappraised the guidelines for administering continuing education requirements, and discussed what improvements could be made to achieve greater efficiency and consistency in the interpretation and enforcement of these requirements in the future.

The continuing education committee also reviewed NASBA's Model Provisions for Required Continuing Education, which have been adopted substantially as written by many states and which have been incorporated in NASBA's Model Rules and Regulations.

Items pending on the committee's agenda for consideration during the coming year include the development of standards for continuing education programs, the desirability of requiring an examination at the completion of continuing education programs, the need for standardized procedures for the approval and reporting of CPE programs, and the need for a uniform proficiency examination and advisory grading service for state boards electing to offer such an examination as an alternative to the continuing education requirement.

Ethics, Quality Control and Enforcement

At the outset of the year, NASBA's Committee on Professional Ethics, under the chairmanship of Gordon R. Jacobson (Oregon), sponsored a special full-day "Seminar on State Board Enforcement Procedures." The seminar was held in conjunction with NASBA's Annual Meeting in October 1974, and was attended by more than 100 state board representatives from 43 states. The seminar was conducted by Sidney H. Willig, J.D., Professor of Law at Temple University and a noted authority on administrative law. Never before has a single NASBA meeting had such an immediate, widespread and uniform influence. Almost without exception, state boards have reported that changes in their enforcement procedures have been proposed or implemented as a result of the seminar. In fact, the seminar was so successful that Professor Willig was asked to conduct a similar session at the Annual Meeting in October 1975.

The ethics committee also reviewed the appropriate provisions of NASBA's Model Rules and Regulations, and studied a preliminary proposal to establish a national register of CPA disciplinary actions.

Of principal concern during the coming year will be the development of state board procedures for controlling the quality of practice. This topic was discussed extensively at NASBA's Annual Meeting in October, and it will receive priority attention during the coming year.

The Uniform CPA Examination

Sixty representatives of state boards of accountancy in 26 states met in New York City in December for NASBA's first "Conference on CPA Examination Administration."

Opening the conference, Louis W. Matusiak (California), Chairman of NASBA's Committee on the CPA Examination, said "We are here to review the entire examination process from beginning to end — not to find fault with it — but to assure ourselves that we indeed are protecting the public and giving the candidates a fair deal. The examination process, like everything else in our society, has become increasingly complex and subject to greater public scrutiny. Added to this is the fact that most of us serve on state boards for only a few years, and unless we fully understand the process and the pitfalls, we unknowingly may jeopardize the reputation of the examination and the integrity of the CPA certificate."

During the next two days conference participants discussed the preparation and grading of the examination, the processing of applications, proctoring and security procedures, and all other aspects of the examination process. Participants also toured the examination grading facilities of the AICPA where the grading of the November 1974 examination was in progress.

The examination committee also focused its attention during the year on the development of uniform examination conditioning requirements. The committee's recommendations on these and other matters have been included in the latest draft of NASBA's Model Rules and Regulations.

In October 1975, NASBA's Board of Directors approved in principle a proposal that NASBA be engaged by the AICPA on a fee basis to conduct an on-going audit of the Uniform CPA Examination process. It is believed that such an audit would protect the integrity and credibility of the examination process, and would assist the state boards in fulfilling their statutory obligation to satisfy themselves as to the propriety of the examination and its administration. This proposal will receive priority attention during the coming year.

Uniform Ethics Examination

Following a three-year study, and the exposure of its preliminary recommendation at NASBA's Regional and Annual Meetings this year, the Board of Directors reaffirmed its recommendation that NASBA encourage the state boards of accountancy to adopt as a requirement for licensure the successful completion of a uniform open-book ethics examination based on a suitable course of instruction in the subject of professional ethics. The Board also endorsed the AICPA's self-study course and examination "Ethics for CPAs" for use by state boards at this time. In addition, the Board agreed that a committee should be appointed to review the ethics course and examination, and to recommend appropriate administrative procedures

and controls for adoption by state boards. It is hoped that within several years all 54 jurisdictions will have uniform procedures for the examination of candidates in the subject of professional ethics.

National Registry

The feasibility of establishing and maintaining a registry of all individuals licensed to practice public accounting in the United States was studied during the year by a special AICPA-NASBA Committee. The committee endorsed the concept of such a registry, but recommended that the project be deferred until there is sufficient demand from prospective users to justify the cost of the undertaking. The committee's report will be reviewed and the need for such a registry will be reassessed during the coming year.

Regional Meetings

More than 150 representatives from state boards of accountancy in 46 jurisdictions participated in NASBA's six Regional Meetings in June. Chaired by NASBA's Regional Directors, the meetings were designed to provide an opportunity for state board members from neighboring states to exchange information on matters of mutual concern. Meetings were held in Dearborn, Michigan; Arlington, Virginia; Nashville, Tennessee; St. Paul, Minnesota; Boston, Massachusetts and Monterey, California.

Topics discussed at each meeting included the proposed revision of NASBA's bylaws, accounting education, ethics enforcement, the Uniform CPA Examination, accountancy legislation, and the report of NASBA's Committee on Planning and Finance. A 90-page booklet containing the meeting agenda and reference materials was sent to all participants in advance and served as background for the discussion at each meeting.

Annual Meeting

NASBA's 68th Annual Meeting in San Antonio, Texas in October, was attended by more than 300 members and guests from 47 jurisdictions.

The program for the Annual Meeting focused on the responsibility of state boards of accountancy to assure the public that all those who are licensed to practice public accounting have demonstrated — and continue to demonstrate — their professional competence.

Addressing himself to the theme "Public Protection and Professional Competence," retiring President, Roger R. Cloutier (Iowa) traced the evolution of state boards of accountancy from part-time admissions committees for the profession's recognition to full-service regulatory agencies for the public's protection. John C. Burton, Chief Accountant of the SEC, commented on the regulation of the profession and the role of the regulatory agencies. A panel of state board representatives and others discussed a number of present and proposed programs for "Controlling the Quality of Practice." Ivan O. Bull, Chairman of the American Institute of CPAs, presented his views on the role of the professional societies, and NASBA's incoming President, W. D. Sprague (New York) discussed the challenges facing state boards and the need for collective action in the year ahead.

At a unique "Issues and Answers" session, spokesmen for NASBA's committees outlined a number of specific issues of interest to state boards. Following this presentation, participants were divided into small discussion groups which attempted to reach a consensus on each issue. At another session, Sidney H. Willig, J.D., Professor of Administrative Law at Temple University, discussed the impact of recent court decisions on the structure and function of state licensing boards. He also analyzed state accountancy statutes, state board regulations and disciplinary procedures, and made some suggestions for improving the regulation of the profession.

At the Annual Business Meeting on October 10, the state boards adopted new bylaws, (see pages 12-18), approved a new dues schedule for member boards and associates (see page 18), accepted the financial statements and auditor's report for the fiscal year ending July 31, 1975 (see pages 19-20), and elected new officers and directors for the coming year (see inside back cover).

Publications

During the year, twelve issues of NASBA NEWS were published and distributed to state boards, state board members and others interested in the regulation of the profession. The newsletter carried more than 85 pages of news and information on NASBA's activities, legislative proposals, court decisions, attorneys general opinions, and other regulatory developments.

A complete directory of state boards and state board members was published and maintained, and more than 200 pages of background and reference materials were produced and distributed in advance of NASBA's conferences and meetings.

Plans also were approved to revise and expand NASBA's newsletter, and to publish a guidebook on state accountancy laws and regulations.

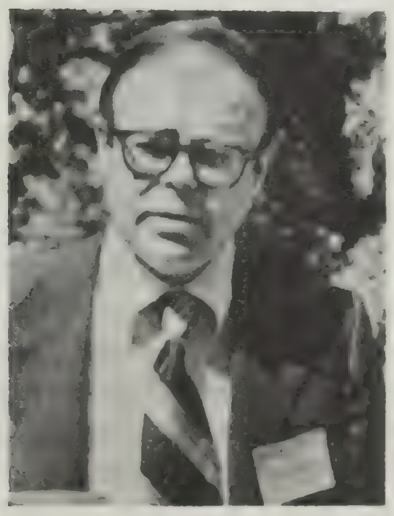
Services

All of NASBA's programs and publications are, in effect, services — services which provide opportunities for state boards of accountancy to counsel together, and services which provide the means for state board members to keep informed. NASBA's office provides a central source of information on all matters of interest to state boards. NASBA's staff, though small, answers hundreds of inquiries each year and is prepared to assist state boards in every way possible. The real service of NASBA, however — and its real benefit to society — comes from the individual members and staff members of the nation's state boards of accountancy. These individuals not only administer the laws of their own states but also take the time to participate in NASBA's activities with a view to attaining greater consistency among the states in the regulation of the accounting profession. The contribution of these volunteers is essential for NASBA's success, necessary for the protection of the public interest, and vital to the strength of the public accounting profession.

Conclusion

It has been said that the strong bring issues to the fore and make decisions on them, while the weak are forced to choose between alternatives they have not chosen for themselves. As the preceding report demonstrates, the state boards of accountancy of the United States, acting through NASBA, have the strength to shape their own alternatives and to realize their full potential in serving the public interest. By working together and by acting collectively, the state boards can use their limited resources more efficiently and discharge their public responsibilities more effectively.

William H. Van Rensselaer
Executive Director



BYLAWS

As Amended October 10, 1975

ARTICLE I
Name

The name of this organization shall be the National Association of State Boards of Accountancy.

ARTICLE II
Purpose

The purpose of the Association shall be to provide an organization through which the state boards of accountancy of the United States may counsel together and obtain such services as they may desire to assist them in discharging their responsibilities for the administration of public accountancy laws and for the protection of the public interest as it is affected by the practice of public accountancy.

ARTICLE III
Membership

SECTION 1. *Members.* The members of the Association shall be the legally constituted boards, departments or instrumentalities of the states, territories and the District of Columbia of the United States of America which have the legal authority to pass on the qualifications of, or to examine applicants for certification or licensure as, certified public accountants, or to regulate the practice of public accountancy within their jurisdictions. Hereinafter the members of the Association shall be referred to as the Member Boards. In a jurisdiction where there is more than one board, department or instrumentality as defined above, they collectively shall constitute a single Member Board under the provisions of these bylaws.

SECTION 2. *Delegates.* All duly appointed or elected members of Member Boards shall be Delegates of the Association so long as they legally are members of a Member Board. Delegates shall have the privilege of the floor at all meetings of the Association and shall be eligible for service as officers, directors, and members of committees of the Association.

SECTION 3. *Associates.* All former delegates or persons who legally have been members of Member Boards shall be Associates of the Association provided the dues established under Article VIII, Section 2, have been paid in full for the current fiscal year. Associates shall have the privilege of the floor at all meetings of the Association and shall be eligible for service as officers, directors and members of

committees within the limitations established in Article IV, Section 6, and in Article VII, Section 1.

ARTICLE IV
Board of Directors and Officers

SECTION 1. *Board of Directors.* Between meetings of the Association, the affairs of the Association shall be administered by a Board of Directors consisting of the Officers and Directors as set forth in Section 2 and 3 of this article.

SECTION 2. *Officers.* The Officers of the Association shall be a President, President-Elect, three Vice-Presidents, a Treasurer, and a Secretary (who shall be the Executive Director, and who shall have no vote on the Board of Directors).

SECTION 3. *Directors.* In addition to the Officers named in Section 2, the Directors of the Association shall be the Immediate-Past-President, three Directors-At-Large, and one Regional Director from each Region established in accordance with the provisions of Article V of these bylaws.

SECTION 4. *Terms of Office.* With the exception of the Secretary, who shall be appointed by and serve at the pleasure of the Board of Directors, the Officers and Directors shall be elected at the regular Annual Meeting of the Association. The Vice-Presidents, the Treasurer, the Directors-At-Large, and the Regional Directors shall serve from the adjournment of the Annual Meeting at which they are elected until the adjournment of the next following Annual Meeting or until their successors are duly elected. The President-Elect shall serve as such from the adjournment of the Annual Meeting at which he is so elected until the adjournment of the next following Annual Meeting, at which time he shall become President and shall serve as such until the adjournment of the next following Annual Meeting, at which time he shall become Immediate-Past-President and Director and shall serve as such until the adjournment of the next following Annual Meeting. No incumbent shall be elected to succeed himself in the offices of President or President-Elect; no person shall be elected for more than two terms in succession as Vice-President, nor more than three terms in succession as Treasurer, Director-At-Large, or Regional Director, (provided, however, that a person shall be eligible for re-election for the number of terms of office herein specified, if during the period immediately prior thereto that person has succeeded to or been appointed to fill a vacancy).

SECTION 5. *Vacancies.* A vacancy in the office of the President shall be filled by the President-Elect. A vacancy in the office of President-Elect shall not be filled until the next Annual Meeting at which time the Nominating Committee will nominate candidates for both President and President-Elect. A vacancy in the office of Immediate-Past-President shall not be filled except by automatic succession provided for herein. Any other vacancy shall be filled by an appointee approved by a majority vote of the Board of Directors to fill out the unexpired term. Such appointee shall meet the qualifications and limitations set forth in Section 6 of this Article.

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SECTION 6. *Qualifications and Limitations.* A majority of all voting members of the Board of Directors shall be Delegates at the time of or within six months prior to their election or appointment. All Regional Directors shall be Delegates at the time of or within six months prior to their election or appointment. All other voting members of the Board of Directors shall be Delegates or Associates at the time of their election or appointment.

SECTION 7. *Duties.* The duties of Officers and Directors shall be such as usually are attached to such offices and such other duties as may be determined from time to time by the Board of Directors.

SECTION 8. *Regular Meetings.* Regular meetings of the Board of Directors shall be held prior to the Annual Meeting of the Association and at such other times as the Board of Directors may designate.

SECTION 9. *Special Meetings.* The President may call special meetings of the Board of Directors at such time and place as he or she shall determine and shall call such special meetings at such time and place as may be designated by the written request of five or more members of the Board of Directors.

SECTION 10. *Notice.* Notice of any regular or special meeting of the Board of Directors shall be sent by whatever means practicable to each Member Board and to each member of the Board of Directors, at their mailing address, as shown in the official records of the Association, at least twenty-one days before such meeting. Such notice, as far as practicable, shall contain a statement of the agenda for such meeting.

SECTION 11. *Quorum.* A majority of the Board of Directors shall constitute a quorum for the transaction of business at any regular or special meeting of the Board. If a majority of Directors are not present at any meeting of the Board of Directors, the majority of the Directors present may adjourn the meeting to a stated time and place without further notice.

SECTION 12. *Attendance.* Any Director who shall fail to attend two consecutive regular meetings of the Board shall be automatically removed from the Board of Directors, except that the Board of Directors may waive such automatic removal if it shall determine that such failure to attend was caused by sufficient circumstances to excuse such absence. The position of Director removed under this provision shall be filled in accordance with Section 5 of this Article.

SECTION 13. *Mail Ballot.* The President may submit any question to the Board of Directors for a vote by mail ballot, and shall do so at the written request of any five Directors. Any action thereon approved in writing by not less than two-thirds of the members of the Board shall be declared by the President an act of the Board and shall be recorded in the minutes of the Board.

ARTICLE V
Regions

SECTION 1. *Purpose and Composition.* In order to establish closer communication between the Board of Directors and the Member Boards, as well as between Member Boards within geographical areas, and to assist the Association in achieving its stated purpose, there shall be at least five but not more than nine geographical Regions, encompassing all states and territories and the District of Columbia of the United States. The names, number and composition of Regions shall be determined from time to time by the Board of Directors.

SECTION 2. *Representation.* A Regional Director shall be elected in accordance with the provisions of Article IV of these bylaws to represent the Board of Directors within each Region and to perform such other duties as may be appropriate.

SECTION 3. *Meetings.* A meeting of the Member Boards within each Region shall be called at least annually by the Regional Director if a meeting of the Member Boards in that Region has not been called otherwise.

ARTICLE VI
Meetings of the Association and Voting

SECTION 1. *Annual Meeting.* The Association shall hold an Annual Meeting at a time and place determined by the Board of Directors of the Association.

SECTION 2. *Special Meetings.* The President shall call special meetings of the Association when requested to do so by the Board of Directors or by any eighteen Member Boards on written application to the President, signed by the chairman or secretary of the said eighteen Member Boards. Special meetings of the Association shall be held at places designated by the Board of Directors.

SECTION 3. *Notice.* Notice of each meeting of the Association shall be sent to each Member Board and to each Delegate and Associate at the mailing address shown in the official records of the Association at least thirty days before such meeting. Such notice, as far as practicable, shall contain a statement of the business to be transacted. Notice of the Annual Meeting shall contain the report of the Committee on Nominations.

SECTION 4. *Quorum.* A quorum for the transaction of business at any meeting of the Association shall be one or more Designated Voting Representatives from a majority of Member Boards. If a majority of Member Boards are not represented by one or more Designated Voting Representatives, the majority of the Member Boards so represented may adjourn the meeting to a stated time and place without further notice.

SECTION 5. *Voting.* Each Member Board shall be entitled to one vote on any matter brought before any meeting of the Association which vote shall be cast on behalf of such Member Board by any individual named by such Member Board as its Designated Voting Representative. Each Designated Voting Representative

shall have authorization from the Member Board he or she represents in order to vote on behalf of such Member Board. A Member Board may name more than one Designated Voting Representative provided that only one vote shall be cast on behalf of such Member Board by its Designated Voting Representatives. A majority vote of all Member Boards shall be required to pass any motion or resolution except those relating to the election of Officers and Directors and those which result in amendments to the bylaws.

SECTION 6. *Mail Ballot.* The Board of Directors, or a majority of the Member Boards of the Association present at any duly called meeting of the Association at which a quorum is present, may direct that the President of the Association submit any question to all Member Boards for a vote by mail except for the election of Officers and Directors. Any resolution enacted in such a mail ballot by two-thirds of the Member Boards voting shall be declared by the President a resolution of the Association provided the two-thirds vote represents a majority vote of all Member Boards.

SECTION 7. *Nominations and Elections.* The report of the Nominating Committee shall be delivered to the Secretary at least sixty days preceding the date of the Annual Meeting of the Association, shall be included with the notice of the Annual Meeting, and shall be presented by said committee at the Annual Meeting. Independent nominations may be made by any two Member Boards if filed with the Secretary at least ten days prior to the Annual Meeting. No nominations from the floor will be recognized. A majority vote of the Member Boards represented at the Annual Meeting by one or more Designated Voting Representatives shall constitute an election, provided a quorum is present.

SECTION 8. *Rules of Order.* The rules of parliamentary procedure contained in Robert's Rules of Order Revised shall govern all meetings of the Association except as may be otherwise provided in these bylaws.

ARTICLE VII
Committees

SECTION 1. *Nominating Committee.* The Board of Directors shall elect annually a nominating committee consisting of one Delegate or Associate from each region, a majority of whom shall be Delegates at the time of their election, and only one of whom may be a member of the Board of Directors. The Committee shall nominate annually one qualified candidate for each office, to wit: President-Elect, three Vice-Presidents, Treasurer, three Directors-At-Large, and one Regional Director from each region. If the President-Elect cannot serve as President, then the committee also shall nominate a candidate for President. The report of the Nominating Committee shall be submitted to the Secretary and presented in accordance with the provisions of Article VI, Sections 3 and 7 of these bylaws.

SECTION 2. *Other Committees.* The President or the Board of Directors may appoint such other committees as they deem necessary. Membership on such

committees is not restricted to Delegates and Associates. The President shall be ex-officio member of all committees except the Nominating Committee.

ARTICLE VIII
Finances

SECTION 1. *Fiscal Year.* The fiscal year of the Association shall be August 1, through July 31.

SECTION 2. *Dues.* The dues for each Member Board and for each Associate shall be determined by the Board of Directors and approved by the Member Boards at a regular Annual Meeting of the Association. The Board of Directors may waive, alter or amend unpaid dues.

SECTION 3. *Other Fees.* The Board of Directors may establish such other fees for publications, programs and services as it deems appropriate from time to time.

SECTION 4. *Audit.* The Board of Directors shall, for each fiscal year, appoint a certified public accountant or certified public accountants to express an opinion on the financial statements of the Association. The financial statements of the Association and the report of the auditor or auditors for each fiscal year shall be published for the information of the membership.

SECTION 5. *Contracts.* The Board of Directors may authorize any officer or officers, agent or agents of the Association, to enter into any contract or execute and deliver any instrument in the name and on behalf of the Association and such authority may be general or confined to specific instances.

SECTION 6. *Checks, Drafts, etc.* All checks, drafts, or other orders for the payment of money, notes or other evidences of indebtedness issued in the name of the Association shall be signed by such officer or officers, agent or agents of the Association and in such manner as shall from time to time be determined by the Board of Directors.

SECTION 7. *Indemnification.* The Association may, by resolution of the Board of Directors, provide for indemnification by the Association of any and all of its Directors or Officers or former Directors or Officers against expenses actually and necessarily incurred by them in connection with the defense of any action, suit, or proceeding in which they or any of them are made parties, or a party, by reason of having been Directors or a Director or Officer of the Association, except in relation to matters as to which such Director or Officer or former Director or Officer shall be adjudged in such action, suit, or proceeding to be liable for gross negligence, or misconduct in the performance of duty and to such matters as shall be settled by agreement predicated on the existence of such liability.

SECTION 8. *Dissolution.* The Association shall use its funds only to accomplish the purpose specified in these bylaws and no part of said funds shall inure, or be distributed, to the members of the Association. On dissolution of the Association, any funds remaining shall be distributed to one or more regularly organized and qualified

charitable, education, scientific, or philanthropic organizations to be selected by the Board of Directors.

ARTICLE IX
Amendments

Any of these bylaws may be altered, amended, repealed, and new bylaws may be adopted by a two-thirds vote of Member Boards represented at any regular or special meeting by one or more Designated Voting Representatives, provided a quorum is present, and provided the two-thirds vote represents a majority vote of all Member Boards, or in accordance with the provision of Article VI, Section 6.

DUES SCHEDULE

Effective with the fiscal year ending July 31, 1976

MEMBER BOARDS

Number of Individual Registrants in State	Annual Dues
1 to 99	$ 150
100 to 499	300
500 to 999	600
1,000 to 1,999	800
2,000 to 4,999	1,000
5,000 to 9,999	1,200
Over 10,000	1,500
Associates	$ 25

NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY
STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS

	Year Ended July 31, 1975		1974	
Cash receipts:				
Dues collected		$19,400		$19,050
Contributions		35,210		49,200
Interest on savings deposits		1,280		2,364
Registration fees:				
Annual meeting		16,965		13,100
Regional meetings		8,172		1,100
		81,027		84,814
Cash disbursements:				
Administration and planning:				
Salaries	$48,364		$43,808	
Payroll taxes and insurance	2,092		1,851	
Employee benefits	4,421		4,194	
Committee on objectives, structure and finance	528		2,685	
Committee on nominations	18		493	
Travel:				
Executive Director	8,034		8,510	
Board of Directors	3,229		1,757	
Stationery and supplies	607		708	
Meeting expense	1,583		1,006	
Furniture and equipment	2,135		51	
Professional fees	340			
Miscellaneous expense	636		1,034	
Communications and meetings:				
Annual report	3,479		2,000	
Annual meeting	16,726		11,260	
Regional meetings	7,616		790	
Awards	610		141	
Other publications			325	
Professional activities:				
Accounting education			736	
Continuing education	755		545	
Professional ethics			823	
CPA examination		101,173	399	83,116
Excess (deficiency) of receipts over disbursements		(20,146)		1,698
Cash balance, beginning of year		34,862		33,164
Cash balance, end of year		$14,716		$34,862

NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY
STATEMENT OF DUES COLLECTED

	Year Ended July 31, 1975	1974
Current year dues	$19,825	$19,050
Deduct unpaid dues:		
Florida	500	
Vermont		75
Current year dues collected	19,325	18,975
Add prior year dues collected:		
Virgin Islands		75
Vermont	75	
Total dues collected	$19,400	$19,050

HURDMAN AND CRANSTOUN

CERTIFIED PUBLIC ACCOUNTANTS · 140 BROADWAY · NEW YORK, N.Y. 10005

Board of Directors
National Association of
State Boards of Accountancy

We have examined the statement of cash receipts and disbursements and the related statement of dues collected of National Association of State Boards of Accountancy for the years ended July 31, 1975 and 1974. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements identified above present fairly the cash receipts and disbursements and the dues collected of National Association of State Boards of Accountancy for the years ended July 31, 1975 and 1974, prepared on a consistent basis.

Hurdman and Cranstoun
Certified Public Accountants

September 19, 1975

NATIONAL ASSOCIATION OF
STATE BOARDS OF ACCOUNTANCY

BOARD OF DIRECTORS

1975-1976

Officers

President — W. Douglas Sprague (New York)
President-Elect — Wilbur H. Stevens (Colorado)
Vice President — Arthur R. Betz (Missouri)
Vice President — Louis W. Matusiak (California)
Vice President — Gerald C. Schroeder (Michigan)
Treasurer — Daniel Goldfarb (Nevada)

Secretary/Executive
Director — William H. Van Rensselaer

Directors

Immediate Past President — Roger R. Cloutier (Iowa)
Director-at-Large — William T. Barnes (District of Columbia)
Director-at-Large — William W. McAbee (Florida)
Director-at-Large — C. Richard Spriggs (California)

Regional Directors

Northeastern — Nathan Honig (New Jersey)
Middle Atlantic — Thomas F. Cardegna (Maryland)
Southern — Charles R. Hatton (Kentucky)
Great Lakes — Thomas M. Lynch (Ohio)
Central — William A. Fleet (Minnesota)
Mountain — Margaret L. Bailey (Colorado)
Pacific — George Matsuda (Hawaii)

nasba

NATIONAL ASSOCIATION OF
STATE BOARDS OF ACCOUNTANCY
1211 Avenue of the Americas, New York, N. Y. 10036

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

13 April 1976

Mr. W. Douglas Sprague
President
National Association of State
Boards of Accountancy
1211 Avenue of the Americas
New York, New York 10036

Dear Mr. Sprague:

The information you sent on 6 April in response to my inquiry of 30 March will be useful to the subcommittee. The 1974-1975 annual report of NASBA is very interesting. However, additional information on the following points is necessary for us to complete our study of the accounting profession.

On page two of the annual report, "The Future Course of NASBA" is mentioned as the final report of the Committee on Objectives, Structure and Finance. Please furnish this subcommittee with a copy of that report along with the names and business affiliations of the members serving on the Committee on Objectives, Structure and Finance.

Page five of the report states that "105 accounting firms and practitioners have contributed more than $130,000 to help support NASBA's activities." Please identify those contributors and the amounts each has contributed.

Finally, on page eight the report states that "NASBA's Board of Directors approved in principle a proposal that NASBA be engaged by the AICPA on a fee basis to conduct an on-going audit of the Uniform CPA Examination process." Please explain in more detail the present role

of NASBA in developing and administering the Uniform CPA Examination, as well as the new audit proposal and the amount of fees which will be involved.

I also hope that you will place this subcommittee on your mailing list. Thank you for your cooperation.

Very truly yours,

Original signed by
Senator Lee Metcalf

nasba

NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY

1211 AVENUE OF THE AMERICAS, NEW YORK, NEW YORK 10036

Office of the President

W. DOUGLAS SPRAGUE
120 East 56th Street
New York, New York 10022

April 28, 1976

The Honorable Lee Metcalf
United States Senate
Washington, D. C. 20510

My dear Senator:

With reference to your letter of April 13, I am enclosing a copy of "The Future Course of NASBA," the final report of the Committee on Objectives, Structure and Finance. The names and addresses of all committee members appear on page 15 of this report.

Also enclosed, as you requested, is a listing of the accounting firms and practitioners which have contributed to our temporary five-year fund raising program, and the amounts which each has contributed. The following suggested schedule of contributions was distributed to all prospective contributors:

Total Partners and Professional Staff	Suggested Contribution
1	$ 25
2 - 9	50
10 - 24	100
25 - 49	200
50 - 99	300
100 - 199	500
200 - 299	1,000
300 - 399	1,500
400 - 499	2,000
500 - 999	2,500
1,000 or more	5,000

NASBA has no direct role in developing and administering the Uniform CPA Examination. The Uniform CPA Examination is developed by the Board of Examiners of the American Institute of CPAs and is administered by the individual state boards of accountancy which elect to utilize this examination. NASBA's role, as described in the various documents we have supplied to you, is to provide such services as the state boards of accountancy desire to assist them in discharging their public responsibilities. Several suggestions for services relating to the Uniform CPA Examination were advanced in the Report of the Committee on Objectives, Structure and Finance. After this report was

reviewed and discussed by the state boards of accountancy, NASBA's Board of Directors proposed that an "Audit Team" be appointed to provide an ongoing review of the preparation, grading and administration of the Uniform CPA Examination process. The Board of Directors authorized NASBA's President and President-Elect to discuss the proposal with the President of the American Institute, and the proposal was accepted by the Institute's Board of Directors in October 1975. Although no fee has been set nor any billings rendered, the fee for the first year is estimated at $60,000.

A brief biographical sketch of the members of our "Audit Team" appears in the February issue of the State Board Report. Copies of the first four issues of this publication are enclosed for your information and future copies will be sent to you as you have requested.

Sincerely yours,

W. Douglas Sprague

W. Douglas Sprague
President

WDS:ac
Enclosures

NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY

CONTRIBUTION RECEIPTS - BY FISCAL YEAR

	1972-1973		1973-1974		1974-1975		1975-1976	
	Amount	Date	Amount	Date	Amount	Date	Amount	Date
1. Elmer Fox & Company	500(1)	4-14-72	500	7- 1-74	500(4)	8-12-75	500	1-27-7
2. Andrew P. Marincovich & Co.	100	8-22-72	100	11-29-73	100	10- 1-74	100	9-12-7
3. Coopers & Lybrand	5,000	9- 1-72	5,000	12-26-73	5,000(4)	8- 1-75		
4. Brock, Schechter & Polakoff	100	9- 1-72	100	8- 2-73	100	8-13-74	100	8-12-7
5. Price Waterhouse & Co.	5,000	9-17-72	5,000	11- 8-73	5,000(4)	9-17-75	5,000	1-20-7
6. Ernst & Ernst	5,000	9-20-72	5,000	12-10-73	5,000	3-28-75		
7. Samuel Klein & Co.	150	9-20-72	150	1-18-74				
8. Mitchell Wiggins & Co.	100	9-20-72	100	11- 9-73	100	10-29-74	100	11-24-7
9. Robert M. Hoyt & Co.	100	9-27-72	100	12- 4-73				
10. Haskins & Sells	5,000	10- 4-72	5,000	12-11-73	5,000	4-16-75	5,000	1-28-
11. Peat, Marwick, Mitchell & Co.	5,000	10-16-72	5,000	1-23-74	5,000	6-19-75	5,000	1-19-7
12. Main Lafrentz & Co.	1,000	11- 3-72	1,000	11- 8-73	1,000	3-26-75	1,000	2- 5-7
13. Walter Shuham	100	12-13-72						
14. A. M. Pullen & Co.	300	12-13-72	300	11- 9-73	300	11-22-74	300	11-11-
15. Laventhol & Horwath	1,000	12-13-72	1,000	2-11-74				
16. Arthur Young & Co.	5,000	12-15-72	5,000	11-16-73	5,000	11-12-74	5,000	11- 6-7
17. Warren B. Cutting	100	12-15-72						
18. Roger R. Cloutier	100	12-15-72	100	10- 8-73	100(4)	10-2-75		
19. Alexander Grant & Co.	1,000	2- 8-73	1,000	11- 6-73	1,000	3-26-75	1,000	11- 5-7
20. Touche Ross & Co.	5,000	2-20-73	5,000	11-12-73	5,000(4)	9-30-75		
21. Charles A. Marseglia	100	2-26-73	100	5- 6-74				
22. Seidman & Seidman	1,000	3-22-73	1,000	3-20-74	1,000	4-30-75	1,000	4-12-7
23. Oppenheim, Appel,Dixon & Co.	500	5- 9-73	500	11- 9-73	500	3-26-75	500	1-19-7
24. S. D. Leidesdorf & Co.	1,000	5-11-73						
25. Arthur Andersen & Co.	5,000	5-29-73	5,000	3- 4-74	5,000	3-26-75	5,000	3- 9-7
26. J. K. Lasser & Co.	250	6-27-73	250	5- 8-74	250	4- 8-75	250	3-10-7
27. McGladrey, Hansen, Dunn & Co.	300(2)	8- 2-73	300(3)	9-13-74	300(4)	9-16-75		
28. Hurdman and Cranstoun	*		*		*			
29. American Institute of CPAs	**		**		**			
30. Harris, Kerr, Forster & Company			500	8-28-73	500	8-22-74		
31. D'Arcangelo & Company	100(2)	9-18-73	100	5-16-74	100	6-24-75	100	1-16-7
32. Murray, Jonson & White			100	12-20-73	100	5-23-75		
33. Andrews, Burket & Co.			100	12-26-73	100	3-12-75	100	1-26-7
34. Dalton, Pennell & Co.			100	12-26-73	100	4- 8-75	100	1-26-7
35. Leatherbury-Broache			100	1- 2-74	100	5-15-75		

	1972-1973 Amount	Date	1973-1974 Amount	Date	1974-1975 Amount	Date	1975-1976 Amount	Date
36. Weaver & Tidwell			250	1- 3-74	250	4- 1-75	250	1-19-76
37. Lucker, Kennedy & Felmeden			100	1- 4-74				
38. Isler, Colling & McAdams			25	2-12-74	25	4- 8-75		
39. Herzinger Porter Addison & Blind			100	3-11-74				
40. Alford, Meroney & Co.			250	4- 5-74	100	4-16-75	100	1-20-76
41. L.A.B. Parker			50	5- 6-74	50	5- 5-75		
42. Neff & Company			300	5-20-74	300	7-11-75	200	3-28-76
43. Kouri, Anderson & Co.			75	5-20-74	75	4- 8-75		
44. Benson & McLaughlin			200	6-14-74				
45. O'Kane, Hunt & Company			50	7-17-74				
46. Frank A Gunnip & Company			100	7-19-74				
47. Gould & Swanson					100	8-13-74		
48. Murphey, Jenne & Jones					100	8-16-74		
49. Windes, McClaughry & Co.					100	8-20-74		
50. Plante & Moran					100	8-20-74		
51. Glenn Ingram & Co.					300	8-28-74		
52. Charles R. Hatton					25	9-24-74	50	8-12-7[illegible]
53. Reavis M. Page					25	9-24-74		
54. Lester Witte & Co.					250	9-24-74		
55. J. Kenneth S. Arthur					10	8-29-74		
56. Bracken & Gardner					50	8-29-74		
57. L.A. Champagne & Co.					50	8-29-74		
58. Hein Christensen					25	8-29-74		
59. Orlando, Vargas, Colon			100(3)	8-29-74	100	3-12-75		
60. Richard E. Darby					25	8-29-74		
61. Rex Meighen & Co.					100	8-29-74		
62. Johnston, Freeman & Jones					25	8-29-74		
63. Juan Acevedo Gonzalez					50	8-29-74		
64. H. A. Gumpf & Associates					50	8-29-74		
65. W. W. Littlejohn					25	8-29-74		
66. McAbee & Company					25	8-29-74		
67. McReynolds & Keith					50	8-29-74		
68. Ralph McQueen & Co.					25	8-29-74		
69. Duplantier,Hrapmann, Hogan & Maher					50	8-29-74		
70. Russell Brown & Co.					25	8-29-74		
71. Odom & Company					100	8-29-74		
72. Robert, Favalora & Pechon					50	8-29-74		
73. J. Earl Pedelahore & Co.					100	8-29-74		
74. Jay A. Phillips					25	8-29-74		
75. Charles M. Potter					25	8-29-74		

	1972-1973 Amount	Date	1973-1974 Amount	Date	1974-1975 Amount	Date	1975-1976 Amount	Date
76. Roberts, Cherry & Co.					25	8-29-74		
77. R. Bob Smith					50	8-29-74		
78. Baird, Kurtz & Dobson					25	8-29-74		
79. Douglas H. Thompson					25	8-29-74		
80. Thurman & Campbell					25	8-29-74		
81. Juan C. Villariny & Co.					25	8-29-74		
82. Griffin, Horne & Co.					25	8-29-74		
83. Marvin W. Maydew					50	9-12-74		
84. George R. Donnell, Esq.					25	10-21-74		
85. Wolf and Company					25	10-29-74		
86. George B. Scott					300	11-12-74		
87. Baylor & Backus					25	12- 5-74		
88. Charles I. Belfint					75	12-18-74		
89. Katherine M. West					100	1-17-75		
90. William H. Scott					25	3-12-75		
91. Adam Thiel					100	3-12-75		
92. Schuldes, Burns, Alk & Denis					25	3-12-75		
93. Owen Loui & Co.					25	3-12-75		
94. Abrams, Meresman & Co.					25	3-12-75		
95. Burnett, Humpherys & Mason					100	3-12-75		
96. Charles H. Towns					50	3-12-75		
97. Ernest M. Acree & Co.					25	3-26-75		
98. Bailey Robirds Nichols & Associates					50	3-26-75		
99. Juncker & McMillan					25	3-26-75		
100. Earl R. Moore					50	3-26-75		
101. Nathan V. Filbey					25	3-26-75		
102. Stone, Gray & Co.					25	4- 1-75		
103. Gerald C. Schroeder & Co.					50	4- 8-75		
104. Leon K. Poche					100	4-16-75		
105. Kermit B. Parrish					100	5- 5-75		
106. James B. Bates					100	6-17-75		
107. Hood and Strong							50	12-1[illegible]-
							200	12-22-
TOTAL CONTRIBUTIONS	47,900		49,200		50,710		31,000	
Adjustments	(900)(a)		-0- (b)		(15,500) (c)		15,900 (d)	
FISCAL YEAR CONTRIBUTIONS	47,000		49,200		35,210		46,900	

NOTES:
(1) Received in 1971-72 fiscal year
(2) Received in 1973-74 fiscal year
(3) Received in 1974-75 fiscal year
(4) Received in 1975-76 fiscal year
* Supplied audit services
** Supplied office services

NOTES:
(a)=Total of (1)+(2)
(b)=Total of (2)-(3)
(c)=Total of (3)-(4)
(d)=Total of (4)

NATIONAL ASSOCIATION OF STATE BOARDS OF ACCOUNTANCY

CONTRIBUTION RECEIPTS FROM ACCOUNTING FIRMS

(Compiled by Subcommittee Staff)

Name of Firm	1972-1973	1973-1974	1974-1975
Arthur Andersen & Co.	$ 5,000	$ 5,000	$ 5,000
Coopers & Lybrand	5,000	5,000	5,000
Ernst & Ernst	5,000	5,000	5,000
Haskins & Sells	5,000	5,000	5,000
Peat, Marwick, Mitchell & Co.	5,000	5,000	5,000
Price Waterhouse & Co.	5,000	5,000	5,000
Touche Ross & Co.	5,000	5,000	5,000
Arthur Young & Co.	5,000	5,000	5,000
Alexander Grant & Co.	1,000	1,000	1,000
Laventhol & Horwath	1,000	1,000	
S. D. Leidesdorf & Co.	1,000		
Main Lafrentz & Co.	1,000	1,000	1,000
Seidman & Seidman	1,000	1,000	1,000
Contributions from others (under $1,000)*	2,900	5,200	7,710
Total Contributions	$47,900	$49,200	$50,710

* Does not include audit services supplied by Hurdman & Cranstoun or office services supplied by American Institute of Certified Public Accountants at no charge

APPENDIX G
OTHER FINANCIAL ACCOUNTING STANDARDS BOARD SPONSORS

ABRAHAM RIBICOFF, CONN., CHAIRMAN
JOHN L. MC CLELLAN, ARK.
HENRY M. JACKSON, WASH.
EDMUND S. MUSKIE, MAINE
LEE METCALF, MONT.
JAMES B. ALLEN, ALA.
LAWTON CHILES, FLA.
SAM NUNN, GA.
JOHN GLENN, OHIO
CHARLES H. PERCY, ILL.
JACOB K. JAVITS, N.Y.
WILLIAM V. ROTH, JR., DEL.
BILL BROCK, TENN.
LOWELL P. WEICKER, JR., CONN.

RICHARD A. WEGMAN
CHIEF COUNSEL AND STAFF DIRECTOR

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

SUBCOMMITTEE:
LEE METCALF, MONT., CHAIRMAN
JOHN L. MC CLELLAN, ARK.
EDMUND S. MUSKIE, MAINE
SAM NUNN, GA.
JOHN GLENN, OHIO
BILL BROCK, TENN.
CHARLES H. PERCY, ILL.
LOWELL P. WEICKER, JR., CONN.

VIC REINEMER, STAFF DIRECTOR
E. WINSLOW TURNER, CHIEF COUNSEL
161 RUSSELL BUILDING

(202) 224-1474

1 April 1976

Mr. C.C. Hornbostel
President
Financial Executives Institute
633 3rd Avenue
New York, New York 10017

Dear Mr. Hornbostel:

As part of its accounting responsibilities, this subcommittee is studying the activities of the Financial Accounting Standards Board (FASB) in setting accounting standards upon which certain Federal agencies rely. The 1974 annual report of the FASB and the Financial Accounting Foundation states:

> "Contributions to the Foundation in 1974 aggregated $4.0 million. More than 1,200 corporations contributed approximately $1.9 million. Some 80% of the corporate total was traceable to the good efforts of the Financial Executives Institute, one of the Foundation's five sponsoring organizations."

The certificate of incorporation, by-laws, and rules of procedure of the FAF and the FASB also provide for participation by your organization in their operations.

This subcommittee needs some basic information on the groups sponsoring the FASB in order to evaluate the relationship between the FASB and Federal agencies. In view of your organization's substantial role in supporting the FASB, please provide the following information to the subcommittee:

1) Copies of any reports FEI may have developed for each of the past three years.

2) The amounts contributed directly or indirectly by FEI to the Financial Accounting Foundation and the Financial Accounting Standards Board in each year since their inception.

3) The identity and corporate affiliation of each FEI member serving on the Financial Accounting Standards Board, the Financial Accounting Standards Advisory Council, or as a trustee of the Financial Accounting Foundation.

4) A brief description of the purpose and activities of the FEI.

5) A brief description as to the number and primary business affiliations of FEI members.

6) The tax status of the FEI.

7) A copy of the latest budget showing amounts and sources of revenues and expenditures.

Your cooperation is appreciated.

Very truly yours,

ORIGINAL SIGNED BY
LEE METCALF

FINANCIAL EXECUTIVES INSTITUTE
833 THIRD AVENUE, NEW YORK, N. Y. 10017 · 212 953-0500

CHARLES C. HORNBOSTEL
PRESIDENT

May 19, 1976

The Honorable Lee Metcalf
Chairman
Subcommittee on Reports, Accounting,
and Management
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

In response to your letter of April 1, 1976, I submit the following information for the questions set forth in your letter.

1. Copies of any reports FEI may have developed for each of the past three years.

   I would appreciate clarification of what your subcommittee would like in connection with this topic. FEI does not develop or issue reports. We do, however, distribute to our membership a monthly magazine called, FINANCIAL EXECUTIVE, and, periodically, issue a publication known as the "Bulletin" and a publication known as the "Alert." We also issue, from time to time, official position papers in response to releases from agencies, such as the SEC, CASB, FTC, GAO, IRS and the FASB.

   If you will let me know which of these documents you prefer to receive, I will see to it that they are sent as a follow-up to this letter.

2. The amounts contributed directly or indirectly by FEI to the Financial Accounting Foundation and the Financial Accounting Standards Board in each year since their inception.

   FEI has not contributed directly or indirectly, at any time, to the FAF or the FASB. FEI has sent letters to its membership requesting our members' companies to participate in the financing of this particular effort.

   It is my understanding that FAF did collect from industry in 1973 a total of $1,588,434 from 920 contributors. It is also my understanding that FAF received $1,899,169 in 1974 and $1,928,349 in 1975 from industry. The total contributors for each of the years were 1,223 in 1974 and 1,398 in 1975.

3. The identity and corporate affiliation of each FEI member serving on the Financial Accounting Standards Board, the Financial Accounting Standards Advisory Council, or as a trustee of the Financial Accounting Foundation.

Financial Accounting Standards Board

Robert E. Mays

Financial Accounting Standards Advisory Council

William E. Buxbaum
Comptroller
E. I. duPont deNemours & Co.

J. O. Edwards
Controller
Exxon Company, U.S.A.

Frank Forester, Jr.
Executive Vice President
Morgan Guaranty Trust Co. of New York

Charles C. Hornbostel
President
Financial Executives Institute

James W. Nethercott
Vice President-Finance & Secretary
Procter & Gamble Company

Richard C. O'Sullivan
Treasurer
Monsanto Company

Robert C. Thompson
Controller
Shell Oil Company

Allan Wear
General Auditor
Ford Motor Company

John A. Willis
Assistant Vice President
Union Carbide Corporation

Financial Accounting Foundation Trustee

Wilbert A. Walker
President (Retired)
U. S. Steel Corporation

4. A brief description of the purpose and activities of the FEI.

FEI is a professional association of top financial executives. It was originally formed as the Controllers Institute of America in 1931. The name of the organization was changed in 1962 to Financial Executives Institute. One of our major functions and purposes is to respond, from the point of view of business, to the various agencies of the government and in the private sector, such as the FASB, on proposed accounting standards and reporting practices and requirements. Positions taken by FEI on releases of the various agencies are the result of volunteer member committees that have been created for this particular purpose.

5. A brief description as to the number and primary business affiliations of FEI members.

   We have 9,241 individual members in FEI today - 7,934 Active members, 277 Academic members, 782 Retired Members, 221 Life Retired members, and 27 Honorary members.

   There are approximately 5,000 companies represented in our membership and I think we can say that there is a very broad industry and geographical distribution within the group.

6. The tax status of the FEI.

   FEI, for tax purposes, is classified as a 501 (C) 6 corporation.

7. A copy of the latest budget showing amounts and sources of revenues and expenditures.

   I am attaching, for your information, a copy of the last three years' Annual Reports, which are published for the benefit of our membership in our "Bulletin" at the end of each fiscal year. These reports will give you the basic sources of revenues and expenditures for each of the three years.

Sincerely,

C. C. Hornbostel

CCH/er
Enclosures

FEI-National Headquarters Financial Statements for the Year Ended June 30, 1975

TREASURER'S REPORT

Total income for 1974–75 was $1,671,909, including $1,118,475 from membership dues and fees, $380,929 from FINANCIAL EXECUTIVE magazine advertising and subscriptions, $158,611 from Conferences and interest and the remaining $13,894 from publication sales and miscellaneous income.

Total expenses amounted to $1,616,526. Included in this total are $717,820 for salaries, pensions, insurance and taxes, $290,105 for the FINANCIAL EXECUTIVE magazine, $122,994 for research and other publications, $88,264 for travel and telephone, $91,934 for rent and electricity, $90,144 for Canadian and Washington office expenses, $38,835 for data processing and $176,430 for all other purposes.

At June 30, 1975 total cash was $1,047,614, including $152,553 in the checking account, $45,061 in the savings account and $850,000 invested in Certificates of Deposit. The fund balance at June 30 increased $55,383 during the year to $686,382, due to an excess of income over expenses.

STATEMENT OF REVENUES AND EXPENSES AND CHANGES IN FUND BALANCE FOR THE YEARS ENDED JUNE 30, 1975 AND 1974

	1975	1974
REVENUES:		
Dues	$1,118,475	$1,060,450
"Financial Executive" (magazine):		
Advertising	273,538	311,968
Earned subscriptions	107,391	96,955
Institute publications sales	11,394	59,145
Conferences (net of related expenses)	56,043	58,159
Interest	102,568	85,781
Miscellaneous	2,500	2,500
Total income	1,671,909	1,674,958
EXPENSES:		
Salaries	599,733	564,545
"Financial Executive"—printing, mailing, advertising, commissions, etc.	290,105	286,530
Research publications	25,705	23,710
Other Institute publications and publicity	97,289	103,919
Allocations to Chapters	36,160	33,800
Rent and electricity	91,934	83,107
Travel	57,247	49,774
Employee benefits—pensions	62,316	59,019
Stationery and supplies	18,265	12,705
Repairs and maintenance	25,275	17,538
Depreciation and amortization	6,594	4,091
Office services	17,208	16,047
Dues and subscriptions	11,237	10,146
Insurance and taxes	55,771	50,644
Postage	20,161	18,902
Telephone and telegraph	31,017	27,350
Computer services	6,121	6,757
Data processing	32,714	1,870
Canadian office expense	56,743	53,362
Government relations	33,401	
Miscellaneous	41,530	24,770
Total before contribution	1,616,526	1,448,586
Contribution to Financial Executives Research Foundation for research projects		48,750
Total expenses	1,616,526	1,497,336
EXCESS OF REVENUES OVER EXPENSES	55,383	177,622
FUND BALANCE, BEGINNING OF YEAR	630,999	453,377
FUND BALANCE, END OF YEAR	$ 686,382	$ 630,999

See Notes to Financial Statements

BALANCE SHEET, JUNE 30, 1975 AND 1974

ASSETS

	1975	1974
CASH:		
Checking account	$ 152,553	$ 61,447
Savings account	45,061	107,180
Total cash	197,614	168,627
INVESTMENTS	850,000	650,000
ACCOUNTS RECEIVABLE AND ACCRUED INTEREST	69,237	65,089
FURNITURE, EQUIPMENT AND LEASEHOLD IMPROVEMENTS—At cost, less accumulated depreciation and amortization of $12,551 in 1975 and $5,957 in 1974	47,458	27,136
OTHER ASSETS	29,325	28,138
TOTAL ASSETS	$1,193,634	$938,990

LIABILITIES AND FUND BALANCE

	1975	1974
Accounts payable and accrued liabilities	$ 85,999	$ 39,502
Unearned subscriptions—"Financial Executive"	92,858	102,624
Prepaid dues	293,395	140,865
Deferred compensation	35,000	25,000
Total liabilities	507,252	307,991
FUND BALANCE	686,382	630,999
TOTAL LIABILITIES AND FUND BALANCE	$1,193,634	$938,990

See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements have been prepared in all material respects on the accrual basis. The financial statements do not include the accounts of the various chapters which operate under charters granted by the Institute.

Receipts for subscriptions to the Institute's magazine, "Financial Executive," are taken into income over the term of the subscriptions.

Depreciation of furniture and equipment is being provided on the straight-line basis over a period of eight

years. Leasehold improvements are being amortized over the life of the lease.

A noncontributory pension plan is in effect covering substantially all full-time permanent employees. Prior-service cost is being amortized over a period of approximately sixteen years. The actuarially computed value of vested benefits in the plan as of September 1, 1974, the date of the latest actuarial valuation, exceeded the assets of the pension fund by approximately $33,000. The Institute's policy is to fund the pension cost accrued. Effective January 1, 1976, the Institute will be required to comply with the participation, vesting and funding requirements of the Employee Retirement Income Security Act of 1974. Although it appears likely that compliance will have the effect of increasing the amount of periodic provision for pension expense, periodic funding of pension costs and unfunded vested benefits, an estimate of such effect will not be available until the necessary actuarial computations have been completed.

It is the practice of the Institute to bear the office and administration expenses of the Financial Executives Research Foundation, Inc. Such expenses for the year ended June 30, 1975 approximated $58,000.

2. INVESTMENTS

Investments consist of certificates of deposit as follows:

	Amount	Interest Rate	Due Date
	$100,000	6 %	July 28, 1975
	550,000	6-1/8	September 3, 1975
	100,000	5-3/4	September 23, 1975
	100,000	6	September 29, 1975
Total....	$850,000		

3. LEASE OBLIGATIONS AND COMMITMENTS

The Institute rents its premises and equipment under leases expiring through 1981. The minimum annual rental commitments are $95,565, $89,453, $86,397, $81,455 and $78,983 for each of the next five years and, for the year ending June 30, 1981, $72,401.

AUDITORS' OPINION

Financial Executives Institute:

We have examined the balance sheet of Financial Executives Institute–National Headquarters as of June 30, 1975 and 1974 and the related statement of revenues and expenses and changes in fund balance for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the above-mentioned financial statements present fairly the financial position of Financial Executives Institute–National Headquarters at June 30, 1975 and 1974 and the results of its operations and changes in fund balance for the years then ended, in conformity with generally accepted accounting principles consistently applied.

NEW YORK, N.Y.
July 25, 1975 *Haskins & Sells*

FINANCIAL EXECUTIVES INSTITUTE
THE VOICE OF CORPORATE FINANCIAL OFFICERS

Financial Executives Institute
is the only effective spokesman for the
total business community.

As proposed rulings
by government and private groups increase,

As rising social concern
forces more responsibility on financial management,

As executives' eyes
turn more toward Washington,

the need for an effective voice
for corporate financial officers has become
increasingly vital.

FEI is 9,000 financial officers representing 5,200 U.S. and Canadian companies—the most sophisticated financial talent in the world.

FEI is the strongest financially oriented management organization in the country.

FEI is the most effective spokesman for the private financial sector of the business community to governmental, professional and academic communities.

FEI is an organization of day-to-day, decision-making executives who know at first hand the problems that face management.

FEI pinpoints in advance the issues that may become problems for business in the areas of financial reporting, financial or cost accounting standards, taxation and employee benefits.

These issues usually arise from proposed legislation or rulings by either government agencies — including the Securities and Exchange Commission and the Cost Accounting Standards Board — or by private groups such as the Financial Accounting Standards Board and the stock exchanges.

FEI technical committees, made up of working financial officers, take a stand on each issue and state the view of corporate management. Two-thirds of the committee must approve the position taken which is then reviewed by the Executive Committee. This decision-making is backed up by in-depth research. The position adopted is presented to selected audiences—such as: the new Financial Accounting Standards Board, the SEC, the IRS, U.S. Government Departments, Congressional Committees, and the stock exchanges.

Clearly, a statement by FEI is not the view of one person — or even several people.

A statement by FEI is the view of corporate management.

This is our strength — our collective strength — your strength, as a member of Financial Executives Institute.

FEI CHAPTERS

EASTERN AREA
Baltimore
Central Pennsylvania
District of Columbia
Long Island
New Jersey
New York City
Northeastern Pennsylvania
Philadelphia
Puerto Rico
Virginia
Westchester

MIDWESTERN AREA
Chicago
Iowa
Kansas City
Michiana
Milwaukee
Nebraska
Rocky Mountain
St. Louis
Twin Cities‡
Western Michigan

‡Minneapolis-St. Paul

WESTERN AREA
Arizona
Calgary
Edmonton
Hawaii
Los Angeles
Portland
San Diego
San Francisco
Seattle
Vancouver
Winnipeg

NORTH CENTRAL
Central Ohio
Cincinnati
Dayton
Detroit
Ft. Wayne
Indianapolis
Louisville
Northeast Ohio
Northwestern Pennsylvania
Pittsburgh
Toledo

SOUTHERN AREA
Atlanta
Birmingham
Central Florida
Chattanooga
Dallas
Fort Worth
Houston
Memphis
Nashville
New Orleans
Northern Carolina
Northern Florida
Oklahoma
Southern Carolinas
Southern Florida

NORTHEASTERN AREA
Albany
Boston
Buffalo
Hamilton
Hartford
Maritime Provinces
Montreal
Rochester
Southern Connecticut
Springfield
Syracuse
Toronto

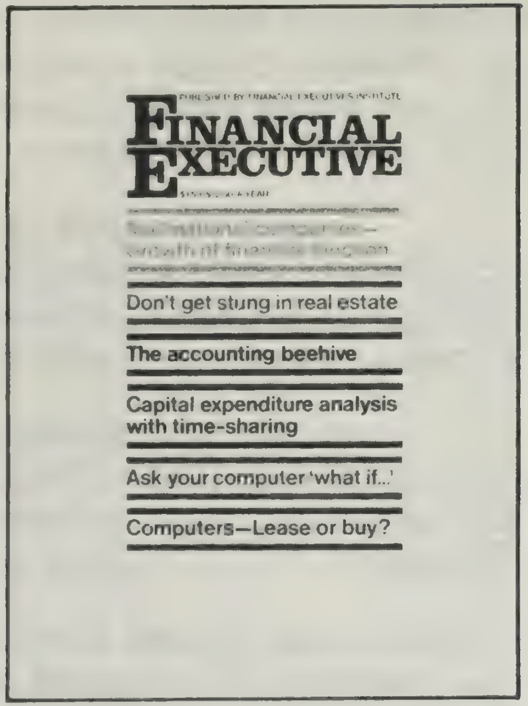
FEI CHAPTERS AND CONFERENCES

At monthly chapter meetings and annual regional conferences, FEI members have the opportunity of meeting informally with the top financial officers of the largest corporations in the U.S. and Canada and with experts on specific problems in financial management. FEI chapters also maintain close liaison with the local academic community.

Each chapter is assigned to one of six geographic areas. Area conferences are held in the spring of each year. Programs at these conferences, attended by members of the FEI chapters in the area, include addresses by leaders in the field of finance and business on topics of interest to all engaged in financial management.

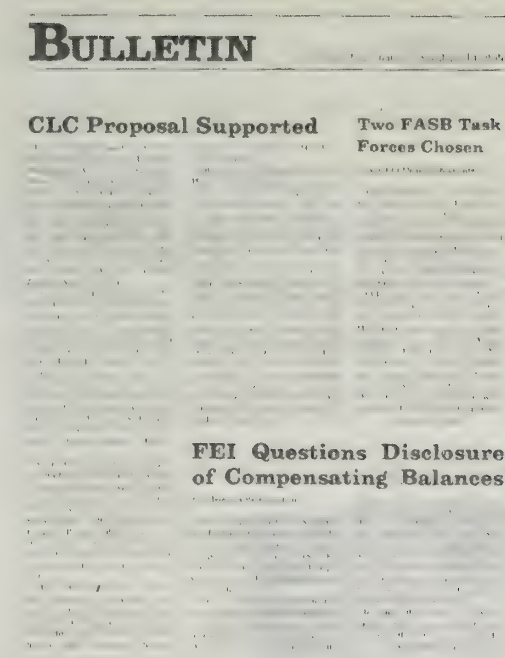
An annual international conference for the entire membership is held in the fall. Members have the opportunity to meet members from other areas and to hear outstanding international and world-famous speakers.

FEI PUBLICATIONS



FINANCIAL EXECUTIVE

is a monthly magazine providing new ideas and practical information on all facets of current corporate financial matters. Written by experts in the field of corporate finance, it is a professional's magazine serving as background for the decision-maker.



FEI BULLETIN

summarizes and makes available to members and other interested audiences the official positions adopted by the Institute. It records significant internal news and provides an historical account of the technical progress of FEI.

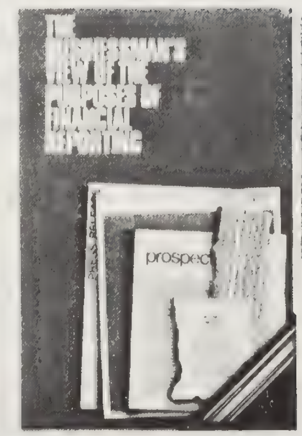
FINANCIAL EXECUTIVES RESEARCH FOUNDATION

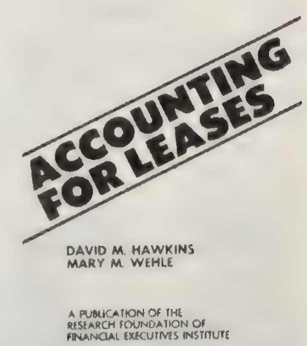
As the research arm of FEI, the research foundation conducts fundamental research in the field of financial management and explores current and future problem areas. These long-range, in-depth publications provide the essential and factual foundations on which Institute policy statements are based.

The efforts of the research foundation are financed in part through FEI member dues and through voluntary contributions from the business community.

FEI research studies have in the past few years been instrumental in influencing the final decision by rule-making bodies such as the SEC and the FASB.

All studies and reports published by the research foundation are distributed to FEI members free-of-charge. Non-members may purchase these publications. A list of current publications is available on request.





RECENT RESEARCH STUDIES

FEI INTERNATIONAL

Recognizing the rising importance of the multinational company in world markets, FEI's International Committee has been instrumental in the organization of associations similar to FEI (yet independent of it) in a number of other countries. At present, FEI-type institutes have been organized in fifteen countries—Argentina, Australia, Belgium, Brazil, France, Italy, Mexico, New Zealand, Peru, The Philippines, South Africa, Spain, United Kingdom, USA & Canada, and West Germany.

Constant liaison with these organizations is maintained through the International Association of Financial Executives Institutes, of which FEI is a founding member. IAFEI holds an annual international congress at which representatives from all Institutes exchange ideas and information.

MEMBERSHIP REQUIREMENTS

Active membership is open to those executives who have major responsibilities in the financial area of companies (or divisions thereof) and financial institutions which qualify in respect to size. Membership is on an individual basis; there are no company memberships. Educators—deans, associate deans, professors and associate professors of finance and accounting—are also eligible.

FEI's goal is to have as members all qualified financial executives. Details of the rules of eligibility for membership are included on the application form.

FINANCIAL EXECUTIVES INSTITUTE
633 THIRD AVENUE, NEW YORK, N Y 10017 · 212 953-0500

June 8, 1976

The Honorable Lee Metcalf
United States Senate
1121 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Metcalf:

Enclosed is a copy of the summary and conclusions of a study by Dr. Robert B. Stobaugh, Professor, Harvard Business School, dealing with the effects on the U.S. Economy resulting from the proposal to tax currently the unremitted foreign earnings of U.S.-controlled corporations with manufacturing operations abroad.

We hope that this document will assist you in your deliberations concerning this proposal which, as the study shows, would cause a loss of jobs in the United States by reducing the competitiveness of U.S. business abroad. We shall forward the complete study to you at an early date.

The positive effects of overseas operations on U.S. employment are illustrated graphically by a recent advertisement, copy enclosed.

Sincerely,

William M. Horne Jr.

William M. Horne, Jr.
Chairman, Committee on Taxation

Encl.
cc: Mr. Paul McKee

From a Study by
ROBERT B. STOBAUGH
Professor, Harvard Business School

Effects on the U.S. economy of proposed U.S. income tax on unremitted foreign earnings of U.S.-controlled manufacturing operations abroad

AUTHOR'S NOTE

Congress has given a lot of attention to the taxation of foreign source income for the past few years. In 1973, I directed a study for the Management Analysis Center that provided the basis for my testimony before the Committee on Ways and Means, U.S. House of Representatives, on June 11, 1973. I updated the 1973 report for testimony before the House Committee on Ways and Means on July 24, 1975.

This current study is a further updated and revised version of the two prior studies, undertaken with funds provided by Financial Executives Research Foundation.

SUMMARY AND CONCLUSIONS

Proposals in Congress. For some time there have been proposals in Congress to increase substantially the U.S. taxes on U.S.-owned operations abroad. One of these proposals is to place a U.S. income tax on the unremitted foreign earnings of U.S.-based companies. Many observers believe that this is likely to receive serious consideration by Congress.

The proposal is often referred to as the "elimination of the deferral of U.S. income tax on foreign earnings." Under the provisions of the current tax law, the profits of foreign corporations owned by U.S. companies are taxed by the host governments at the time they are earned, but such profits are not taxed by the U.S. government until they are remitted to the United States. Hence, U.S. taxes are said to be "deferred" until such time as profits are remitted. At the time of remittance, the profits are taxed at the U.S. rate, except that a credit is given for the income taxes and dividend-withholding taxes which have been paid to the foreign government. Thus, in effect, U.S. taxes are collected to the extent that the rate of the total of foreign income and dividend-withholding taxes is less than the rate of U.S. income taxes. (There are certain exceptions to this general rule.)

Effects on taxes and balance of payments. If the United States

were to place a tax on unremitted earnings, then U.S.-owned foreign subsidiaries operating in countries with lower tax rates than the United States would be placed at a competitive disadvantage with their foreign competitors, which would continue to pay only local taxes on unremitted earnings.

In this report, we estimate the effect that the legislation would have on selected aspects of the U.S. economy, principally on U.S. taxes collected and on the U.S. balance of payments. We do this by taking into account the foreign tax rates and the probable changes in competitive positions of U.S. firms over time. These estimates, although based on the most relevant data and concepts that we could find, still incorporate a certain amount of judgement. Good data are hard to come by; but even when good data are available, no mathematical formula exists to give an unequivocal answer.

Foreign competition. The foreign competitors of U.S. companies operating abroad are primarily multinational firms headquartered in Europe, Japan and Canada. These foreign multinationals on the average are both larger and growing more rapidly than their U.S. counterparts. For instance, in 1971 American companies ranked first in worldwide sales in seven of the nine industries that account for over 90 percent of U.S. foreign direct investment in manufacturing, but by 1973 they ranked largest in only four of the same nine industries. This is but one example of the loss of competitive position by U.S. companies; others will be cited below. No one has studied why American firms seem to be losing their competitive race; but it seems unquestionable that increasing the taxes on their foreign operations would make them lose ground even faster.

In fact, evidence suggests that our government, rather than placing handicaps on the foreign operations of American companies, should consider whether to encourage them to expand abroad even more. Studies indicate that U.S. operations abroad are beneficial to the American economy. The U.S. companies that invest abroad are the strongest part of that economy. Employment in the United States within these firms has been increasing, whereas employment in other U.S. manufacturing companies has been decreasing. Furthermore, in the nine U.S. industries that account for over 90 percent of U.S. foreign direct investment in manufacturing, wages and salaries of American employees have been increasing faster than the average of the other U.S. manufacturing industries. As a result, the average income of the employees in the United States in these nine industries exceeds that of the average of the employees in the other U.S. manufacturing industries by about $4,000 a year.

Multinationals create U.S. jobs. Using every bit of information available to us, we analyzed the effects of the foreign operations of American companies on both U.S. employment and the U.S. balance of payments. Our best estimate is that 700,000 American jobs and a balance-of-payments surplus of $7 billion are created by U.S. operations abroad. These, of course, are very rough approximations

because an accurate figure is impossible. But it seems very likely that if U.S. companies did not have these foreign operations, the United States would have fewer job opportunities and a weaker dollar than exist today.

Weaker multinationals mean lower tax revenues. To be sure, if the U.S. government were to increase the amount of taxes collected from the foreign operations of American companies, the U.S. government revenues would immediately increase. But this would weaken the foreign operations of the U.S. companies vis-a-vis their foreign competitors; as a result, U.S. job opportunities would decrease and U.S. per capita income would be lower than with the present tax laws. And a point often overlooked is that the initial increase in tax revenues of the U.S. government would be turned into a net loss after a period of time, which we estimate, with the aid of a computer simulation model, to be from five to eight years.

Rather than raise taxes on U.S. companies operating abroad, the government should begin work on a multilateral tax agreement with other nations where multinational companies are headquartered, in order to ensure that American companies do not pay any higher taxes on their foreign operations than do their foreign competitors.

We recognize that these conclusions differ substantially from statements of some observers. We are presenting the detailed analysis in this report to aid national policymakers in determining which set of conclusions is most correct.

FINANCIAL EXECUTIVES INSTITUTE
633 THIRD AVENUE, NEW YORK, N.Y. 10017 · 212 953-0500

CHARLES C. HORNBOSTEL
PRESIDENT

July 14, 1976

The Honorable Abraham A. Ribicoff
Chairman
Committee on Government Operations
United States Senate
Washington, D. C. 20515

Dear Mr. Chairman:

Financial Executives Institute is the recognized professional association of more than 9,000 senior financial and administrative executives in over 5,000 American corporations. The companies represented by our individual members constitute a broad cross-section of the U. S. economy. FEI does not, as a matter of policy, express views or take a position on matters affecting any single industry. However, we believe the issues involved in the "Haskell Amendment" (Title V "Office of Energy Information and Analysis") to H. R. 12169 as amended and passed by the Senate on June 17, 1976, are of such importance that they transcend industry boundaries and are of significance to business firms in general. We urge Senate Conferees not to adopt Title V of H. R. 12169, "Federal Energy Administration Extension Act."

By empowering the Director of the Federal Energy Administration to develop accounting practices to be followed by all energy producing companies, Title V of H. R. 12169 is in direct conflict with Title V of Public Law 94-163 enacted into law as recently as December 22, 1975, as well as the statutory authority of the SEC and the efforts of the Financial Accounting Standards Board to establish financial accounting standards. Specifically, the FASB, as contemplated by the provisions of Sec. 503(b)(2) of Public Law 94-163, has undertaken a project on financial accounting and reporting in the extractive industries. As a matter of fact, working sessions of the FASB Task Force for this project are attended by monitors from the Securities and Exchange Commission, the General Accounting Office, the Cost Accounting Standards Board, the Federal Energy Administration, the Federal Power Commission, and the House Subcommittee on Oversight and Investigations. The FASB fully expects to complete this project on or before December 25, 1977, as required by Public Law 94-163.

Financial Executives Institute has long taken an active role in the process of developing financial accounting and reporting standards. Our activities involve frequent interaction with standard-setting bodies such as the SEC, GAO, AICPA, CASB, and FASB. FEI believes improved standards are essential to provide investors and the public with more useful, comprehensible information to enhance the credibility of financial reports; however, the process is complex and at times seems long and tedious. For these reasons, FEI has committed its support to the Financial Accounting Standards Board. The SEC, as well as CASB, AICPA, NAA and AAA have publicly expressed support for the FASB without relinquishing their respective roles in the development of accounting and reporting standards.

Although the FASB is relatively new, it is making good progress toward fulfilling its important role. Considerable time and effort and many millions of dollars have gone into establishing a viable process of developing financial standards wherein all interested parties can be represented. Our experience convinces us that enactment of Title V, and more specifically Section 38 thereof, would be a serious setback to the FASB and that it would significantly impede the development of financial accounting and reporting standards for all business firms.

We want to emphasize that FEI is not expressing an opinion or taking any position on the merits of the basic legislation contained in H. R. 12169 as a whole. We fully recognize that it is important to obtain meaningful financial and other operating data to establish our nation's energy policies. However, based upon our experience as preparers, issuers, and users of corporate financial reports, and on our role in the development of financial accounting and reporting standards, we believe that Title V should be deleted in its entirety, because it represents a massive duplication of effort, and its enactment could seriously impede the development of improved financial accounting and reporting standards for all business firms.

Sincerely,

CCHornbostel

C. C. Hornbostel

cc: Senate Conferees on Federal Energy Administration Act

CCH:dmd

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

2 April, 1976

Mr. William M. Young, Jr.
National Association of Accountants
919 Third Avenue
New York, New York 10022

Dear Mr. Young:

As part of its accounting responsibilities, this subcommittee is studying the activities of the Financial Accounting Standards Board (FASB) in setting accounting standards upon which certain Federal agencies rely. The 1974 annual report of the FASB and the Financial Accounting Foundation states:

> The Board of Trustees of the Foundation consists of nine Trustees. In essence, Trustees are selected from nominations by five organizations, usually referred to as sponsoring organizations. These sponsoring organizations, each of which has a continuing interest in financial reporting, are:
>
> - American Accounting Association
> - American Institute of Certified Public Accountants
> - Financial Analysts Federation
> - Financial Executive Institute
> - National Association of Accountants
>
> The Trustees rely heavily on the help of the sponsoring organizations in raising the required funds each year, for the recommendation of qualified candidates for appointment to the Standards Board and the Advisory Council, and for suggestions as to how the primary purpose can best be achieved. The

Standards Board also receives valuable
research assistance from the sponsoring
organizations.

This subcommittee needs some basic information on the groups sponsoring the FASB in order to evaluate the relationship between the FASB and Federal agencies. In view of your organization's role in supporting the FASB, please provide the following information to the subcommittee.

1. Copies of any reports your organization may have developed for each of the past three years.

2. The amounts contributed directly or indirectly by your organization to the Financial Accounting Foundation and the Financial Accounting Standards Board in each year since their inception.

3. The identity and business affiliations for each of your organization's members serving on the Financial accounting Standards Board, the Financial Accounting Standards Advisory Council, or as a trustee of the Financial Accounting Foundation.

4. A brief description of the purpose and activities of your organization.

5. A brief description as to the number and primary business affiliations of your organization's members.

6. The tax status of your organization.

7. A copy of the latest budget showing amounts and sources of revenues and expenditures.

Your cooperation is appreciated.

Very truly yours,

Original signed by
Senator Lee Metcalf

NATIONAL ASSOCIATION OF ACCOUNTANTS
919 THIRD AVENUE
NEW YORK, NEW YORK 10022

WILLIAM M. YOUNG, JR.
EXECUTIVE DIRECTOR

April 22, 1976

The Honorable Lee Metcalf
The United States Senate
Washington, D.C. 20510

Dear Sir:

RE: Committee on Government Operations
Subcommittee on Reports, Accounting
and Management

Regarding your letter of April 2 and inquiry with respect to the National Association of Accountants' relationship to the Financial Accounting Standards Board, I am pleased to submit the following and material enclosed in the order of the questions asked:

(1) We are somewhat concerned about complying with copies of any reports which our Association may have developed in the last three years. We have some 36 committees and subcommittees, all of which prepare reports on their work. In addition, we prepare research reports for our members, as well as numerous letters of response to governmental agencies such as the CASB, SEC, IRS, etc. With respect to the FASB, we have written approximately 18 comment letters to this body. These, of course, have been published and I believe they are part of the public domain. May we request a more definite communication of the specific reports which you would like to receive.

(2) Since 1972 our cash contributions to the operations of the FASB have totaled $103,500. In addition, we have incurred direct expenses of $19,826.49 in soliciting our membership for contributions. The latter figure does not include approximately $5,000 of staff time and overhead in making the solicitation.

(3) With respect to the identity and business affiliations of our members serving the FASB, we have only one representative on the FAF. He is Mr. William H. Franklin, retired Chairman of Caterpillar Tractor Co., Peoria, Illinois. There are several members of the FASB and its Advisory Council who are members of the NAA as well as members of other professional bodies, but they are not our representatives.

(4) The purposes and activities of our Association are contained in our Constitution and By-Laws, the latest copy of which is enclosed.

(5) An analysis of our membership and its primary business affiliations is also included in the copy of our publisher's statement, dated December 31, 1975, also attached.

(6) We have been advised by the Internal Revenue Service that we are not a private foundation and our tax status classification is under Section 501(c)(3) of the Internal Revenue Code.

(7) With respect to our sources of revenue and expenses, there is enclosed a copy of our official bulletin, Management Accounting.

On page 67-70 appear our financial statements for the years ending June 30, 1974 and 1975.

If I can be of further assistance to you, please do not hesitate to let me know.

Very truly yours,

W. M. Young Jr.

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enclosures

NATIONAL ASSOCIATION OF ACCOUNTANTS

STATEMENTS OF ASSETS, LIABILITIES AND FUND BALANCES

CURRENT OPERATING FUND

ASSETS	June 30, 1975	June 30, 1974	LIABILITIES AND FUND BALANCES	June 30, 1975	June 30, 1974
Cash	$ 339,957	$ 151,154	Accounts payable and accrued liabilities	$ 124,822	$ 156,536
Marketable securities, at cost which approximates market	1,800,000	1,950,000	Deferred membership dues	1,617,522	1,560,993
Furniture, equipment and leasehold improvements—net	390,687	423,187	Socio-Economic Program contributed reserve	65,015	65,015
Other assets	118,053	83,099	Fund balance	841,338	824,896
	$2,648,697	$2,607,440		$2,648,697	$2,607,440

RESERVE FUND

ASSETS	June 30, 1975	June 30, 1974	LIABILITIES AND FUND BALANCES	June 30, 1975	June 30, 1974
Cash	$ 24,960	$ 8,855	Fund Balance:		
Marketable securities, at cost (quoted market value at June 30, 1975 and 1974 approximates $2,359,000 and $2,122,000, respectively)	2,502,948	2,468,311	Beginning of year	$2,477,166	$2,390,108
			Initiation fees	106,020	111,750
			Net (loss) on sale of securities	(55,278)	(24,692)
	$2,527,908	$2,477,166	End of year	$2,527,908	$2,477,166

MEMORIAL EDUCATION FUND

ASSETS	June 30, 1975	June 30, 1974	LIABILITIES AND FUND BALANCES	June 30, 1975	June 30, 1974
Cash	$ 61,958	$ 4,269	Fund Balance:		
Marketable security, at cost which approximates market		50,000	Beginning of year	$ 54,269	$ 48,397
			Donations received	2,775	2,563
			Interest income	4,914	3,309
	$ 61,958	$ 54,269	End of year	$ 61,958	$ 54,269

See Notes to Financial Statements.

NATIONAL ASSOCIATION OF ACCOUNTANTS

STATEMENT OF REVENUES AND EXPENSES AND CHANGE IN FUND BALANCE—CURRENT OPERATING FUND

	For the Year Ended June 30	
	1975	1974
REVENUES:		
Membership dues	$3,061,841	$2,884,331
Continuing education program—registration fees and sales of materials	493,816	463,753
Annual conference—registration fees	177,581	137,096
Interest and dividends on Reserve Fund investments	123,042	102,086
Interest on Current Operating Fund investments	149,253	138,426
Advertising and sales of publications	180,371	160,170
Institute of Management Accounting—registration and examination fees	169,801	75,868
Miscellaneous	53,107	25,338
Total	4,408,812	3,987,068
EXPENSES:		
Payments to chapters	615,767	591,339
Member records and chapter services	670,059	558,970
Membership and chapter development	119,586	97,732
Technical publications	538,941	473,981
Continuing education programs	478,452	383,213
Research and Management Accounting Practices Projects	222,656	155,920
Institute of Management Accounting	214,368	175,840
Public relations and promotion	113,691	90,842
General office services	826,428	747,005
Administration	429,697	361,323
Annual conference	162,725	128,730
Total	4,392,370	3,764,895
EXCESS OF REVENUES OVER EXPENSES	16,442	222,173
FUND BALANCE, BEGINNING OF YEAR	824,896	602,723
FUND BALANCE, END OF YEAR	$ 841,338	$ 824,896

See Notes to Financial Statements.

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STATEMENT OF CHANGES IN FINANCIAL POSITION— CURRENT OPERATING FUND

	For the Year Ended June 30	
	1975	1974
SOURCES OF FUNDS:		
From operations:		
Excess of revenues over expenses	$ 16,442	$222,173
Expenses not requiring outlays of funds— depreciation and amortization	87,235	77,942
Total from operations	103,677	300,115
Increase in deferred membership dues	56,529	102,766
Decrease in marketable securities	150,000	68,232
Total sources	310,206	471,113
USES OF FUNDS:		
Decrease in accounts payable and accrued liabilities	31,714	68,657
Acquisitions of furniture, equipment and leasehold improvements	52,290	362,912
Increase in other assets	37,399	8,973
Total uses	121,403	440,542
NET INCREASE IN CASH BALANCE	188,803	30,571
CASH, BEGINNING OF YEAR	151,154	120,583
CASH, END OF YEAR	$339,957	$151,154

See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Chapter Treasuries and Regional Councils

The funds and accounts of Chapter Treasuries and Regional Councils are not included in the accompanying financial statements.

Socio-Economic Program

The Association conducts a Socio-Economic Program which is funded by the United States Department of Commerce—Office of Minority Business Enterprise under a cost reimbursement type contract in the maximum amount of $152,400 for each of the years ended June 30, 1974 and 1975. The expenditures under the Program and the reimbursement thereof approximate the maximum amount in both years and are not included in the revenues and expenses of the Current Operating Fund.

Marketable Securities

Marketable securities are carried at cost determined on an average basis.

Furniture, Equipment and Leasehold Improvements

Furniture, equipment and leasehold improvements are carried at cost.

Depreciation and amortization are computed on the straight-line method. Leasehold improvements are amortized over the term of the lease or the estimated useful lives of the assets, whichever is the shorter period. Furniture and equipment are depreciated over their estimated useful lives.

Revenue Recognition

Membership dues are recorded as revenue during the applicable membership period.

The Association's monthly publication entitled "Management Accounting" is distributed to all members. However, no portion of members' annual dues is allocated to subscription revenues in the accompanying statement of revenues and expenses and change in fund balance of the Current Operating Fund.
Registration and/or examination fees are recorded as revenue when the applicable event occurs.
Advertising revenues are recorded as revenue when the applicable publications are issued.

Research Studies
Costs of research studies are charged to expense as incurred.

B. SPECIAL PURPOSE FUNDS
The Reserve Fund was established for the purpose of providing funds which may be utilized to insure continuous extension and development of activities for the best interests of members. The principal of the Reserve Fund is accumulated through initiation fees and gains and losses on sales of securities of the Fund. Interest and dividends earned on investments of the Fund are recorded in the Current Operating Fund. No appropriations may be made from the Fund except upon affirmative vote of the majority of the Board of Directors.
The Memorial Education Fund was established for the purpose of accepting and holding funds to support and further the educational goals of the Association. Donations and gifts are received by the Fund from interested parties. All money and property received by the Fund is administered separately from the other funds of the Association by a committee whose actions are subject to the approval of the Executive Committee.

C. FURNITURE, EQUIPMENT AND LEASEHOLD IMPROVEMENTS
As of June 30, 1975 and 1974, furniture, equipment and leasehold improvements consisted of the following:

	1975	1974
Furniture and equipment	$510,774	$458,897
Leasehold improvements	84,392	83,979
Total	595,166	542,876
Less accumulated depreciation and amortization	204,479	119,689
Furniture, equipment and leasehold improvements—net	$390,687	$423,187

D. PENSION PLAN
The Association has a non-contributory pension plan covering substantially all employees. Total pension expense charged to income was approximately $135,000 and $90,000 for the years ended June 30, 1975 and 1974, respectively; the increased pension expense in 1975 results primarily from new entrants into the plan. The unfunded past service cost is being amortized over periods not exceeding 20 years. It is the Association's policy to fund pension cost accrued. At June 30, 1975 the pension fund assets exceeded the actuarially computed value of vested benefits.

E. MARKETABLE SECURITIES—RESERVE FUND
Although the quoted market value of marketable securities in the Reserve Fund is less than the cost of such securities no provision for losses has been made. The securities are considered by the Association and its independent investment bankers to be long-term investments and the decline in market value is considered to be temporary.

F. LEASE COMMITMENTS
The Association's long-term lease for office space requires minimum annual rental payments of approximately $201,000 plus certain escalation charges to 1985. Rent expense (which is included in "General Office Services" expenses) aggregated $210,493 and $195,546 for the years ended June 30, 1975 and 1974, respectively, which amounts are net of rents received from subleases amounting to $57,668 for both years. Two portions of the office space have been subleased at annual rentals, including escalation charges, of approximately $37,000 and $21,000 through 1980 and 1975, respectively.

G. RECLASSIFICATION
Certain amounts have been reclassified in the 1974 financial statement to conform with the 1975 presentation.

HASKINS & SELLS
CERTIFIED PUBLIC ACCOUNTANTS

TWO BROADWAY
NEW YORK, N.Y. 10004

AUDITORS' OPINION

To the Board of Directors of the
National Association of Accountants:

We have examined the statements of assets, liabilities and fund balances of the Current Operating Fund, Reserve Fund, and Memorial Education Fund of the National Association of Accountants as of June 30, 1975 and 1974, and the related statements of revenues and expenses and change in fund balance and changes in financial position of the Current Operating Fund for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements present fairly the assets, liabilities and fund balances of the Current Operating Fund, Reserve Fund and Memorial Education Fund of the National Association of Accountants as of June 30, 1975 and 1974, and the results of operations, change in fund balance and changes in financial position of the Current Operating Fund, and the changes in fund balances of the Reserve Fund and the Memorial Education Fund for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Haskins & Sells

August 20, 1975

THE EXECUTIVE DIRECTOR'S REPORT

Improved services at lowest cost to the members is the general guideline by which the national office under the direction of the Board of Directors is conducted. I believe most of the significant results of 1974-75 reflect this philosophy.

It was a difficult year for all companies, and associations, in particular, but I believe the Association did remarkably well, ending up with a surplus. Moreover, the rate of increase in membership acquisition and the complementary decline in the rate of retention losses was heartening. At 70,500 our membership is at the highest point in history.

A study made by Oliver Quayle & Associates completed earlier in the year showed that in the main the Association is achieving its objectives, based upon the opinions of the scientific sample of members polled. The survey will be useful in future planning and, of course, the Committee on Planning is finding it particularly useful in determining where the Association should go in the years ahead.

The survey pointed out a need, for example, for the Association to develop highly specialized programs for a sophisticated segment of the membership and different types of educational services that will serve members throughout their careers, not just at the beginning and midpoint. Although the international membership was not polled, we have started an in-depth study of international chapter organization and services to members living outside the United States.

President Bartholomew and I reviewed problems and opportunities in the international area when we flew to Europe early this year. We met with our counterparts at the British Institute of Cost and Management Accountants and participated in seminars with the Brussels and Zurich NAA chapters. The enthusiasm of the European chapter members brought home very vividly the need for American accounting know-how by European accountants.

Not only did we meet with our British colleagues, we also participated in a tripartite meeting with the Society of Industrial Accountants of Canada in Bermuda. As representatives of the world's three largest societies of management accountants, we discussed matters of mutual interest and areas where cooperation might be possible. The SIA and NAA jointly published a research study this year, one example of successful cooperation between the organizations.

Meanwhile, our continuing effort to make staff operations more efficient and cost effective focused on three areas. We installed the Centrex telephone system. Under this system, members may dial a staff person directly without going through a central switchboard, and staff personnel can set up conference calls with up to three callers participating. This should help speed up our response time and improve staff services to members.

Plans to establish a word processing center in the national office are well under way. Under this concept of office organization, all correspondence, typing, copying and other functions are centralized for more efficiency. We anticipate substantial savings and better service to members, chapters and councils when the center is completed.

To help membership retention, we plan to hire a person to contact resigned and terminated members. Initial studies have indicated that this staff function will more than pay for itself through the regaining of members.

Requests from both domestic and international members

NAA's President and Executive Director meet in Bermuda with officers and staff heads of the Society of Industrial Accountants of Canada and the Institute of Cost and Management Accountants of the United Kingdom. Clockwise, Executive Director W. M. Young, Jr., is fourth person at table; while President Bartholomew is at this end with back to camera.

have spurred us to give a high priority in putting the NAA speakers bureau on the computer as soon as possible. The program should be on line in time for chapter use for their programs for 1976-77. Once the program is computerized, it can be easily updated on a regular basis.

In other matters, Managing Director Jack Vavasour has been engaged in an effort to qualify the Association as a sales tax exempt organization in states where we conduct some of our operations, like Michigan, home of the Institute of Management Accounting, and states where we hold our Annual Conferences. A program to automatically exempt NAA chapters year after year from federal taxes is now complete and a similar program for the regional councils will be put in operation.

In keeping with our greater participation and involvement in our society and government, I attended a special briefing on the economy and productivity, held at the White House, along with other Association executives. The meeting was very worthwhile in acquainting us with the larger picture.

I believe the past year proves that our Association can function within an adverse economic environment as well as in good times. But the smooth running operation owes much to the dedicated volunteers who donated their time and abilities to the Association. Some of them are listed on the following pages. NAA members owe them a debt of gratitude for their outstanding leadership.

W. M. YOUNG, JR.
Executive Director

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

29 April, 1976

Mr. William M. Young, Jr.
Executive Director
National Association of Accountants
919 Thirs Avenue
New York, New York 10022

Dear Mr. Young:

I have received your letter of 22 April in response to my 2 April request for information on your organization. The information you enclosed will be helpful to the subcommittee, but some clarification of my request and your response seems necessary.

Regarding our request for reports, please provide the subcommittee with copies of comments or presentations your organization has given on public issues to the Financial Accounting Standards Board, federal or state agencies, Congress, or state legislatures since 1 January, 1975.

Please break down your organization's contributions to the FASB by year and indicate where the annual contributions are included on the statement of revenues and expenses. What are the annual dues for members of the National Association of Accountants?

With respect to the NAA members serving on the Financial Accounting Foundation, the FASB, and the FASB Advisory Council, please identify all NAA members serving on those bodies even though they are not expressly representing the NAA.

Your cooperation in providing this information by 15 May will be greatly appreciated. Any further requests for clarification may be directed by telephone to Subcommittee Counsel Jack Chesson at 202/224-1474.

Very truly yours,

Lee Metcalf

NATIONAL ASSOCIATION OF ACCOUNTANTS
919 THIRD AVENUE
NEW YORK, NEW YORK 10022

WILLIAM M. YOUNG, JR.
EXECUTIVE DIRECTOR

May 12, 1976

The Honorable Lee Metcalf
The United States Senate
Washington, D. C. 20510

MAY 14 1976

Dear Sir:

RE: Committee on Government Operations
Subcommittee on Reports, Accounting
and Management

Replying to your letter of April 29, I am pleased to enclose copies of the reports which you have requested. These have been arranged on the basis of the index furnished at the head of the body of the material.

Regarding our organization's contributions to the FASB, in 1972-73 we incurred direct expenses of $10,710.69; in 1973-74 our total contributions amounted to $37,615.80 of which $9,115.80 were direct expenses; in 1974-75 and in 1975-76 we contributed $37,500 in each year. In our statements of revenues and expenses, these amounts are included in the line headed "Administration."

Regarding Association dues, for domestic and Canadian members they are $45 a year; for overseas members they are $35 and for students they are $10.

Regarding our members who are serving on the various bodies of the FAF and the FASB, you will find them listed on an attached summary.

Very truly yours,

WMY:lcj
Enclosures

National Association of Accountants

NAA Members serving on the FAF, FASB and the Advisory Council

TRUSTEES

Richard T. Baker	Managing Partner, Ernst & Ernst
James Don Edwards	Distinguished Professor of Accounting College of Business Administration University of Georgia
William H. Franklin	Chairman (Retired) Caterpillar Tractor Co.
Ralph E. Kent	Senior Partner, Arthur Young & Co.

FASB MEMBER

Arthur L. Litke	Chief, Office of Accounting & Finance, Federal Power Commission

FASB ADVISORY COUNCIL

Andrew Barr	Chief Accountant (Retired) SEC
Norton M. Bedford	Arthur Young Distinguished Professor and Head of Dept. of Accountancy, University of Illinois
George R. Catlett	Senior Partner, Arthur Andersen & Co.
Joseph P. Cummings	Deputy Senor Partner, Peat, Marwick, Mitchell & Co.
Charles G. Gillette	Partner, Arthur Young & Co.
Charles T. Horngren	Edmund W. Littlefield Professor, Graduate School of Business, Stanford University
Harold Q. Langenderfer	Peat, Marwick, Mitchell Professor of Professional Accounting, Graduate School of Business Administration, University of North Carolina
Raymond C. Lauver	Partner, Price Waterhouse & Co.
Robert A. Morgan	Controller, Caterpillar Tractor Co.
E. Palmer Tang	Senior Partner, Touche Ross & Co.
John A. Willis	Assistant Vice President, Union Carbide Corporation

NATIONAL ASSOCIATION OF ACCOUNTANTS

MANAGEMENT ACCOUNTING PRACTICES COMMITTEE COMMENTS

1 Jan 75 - 30 Apr 76

Date	Agency	Subject
16 Jul 75	U.S. House of Rep. Committee on Banking Subcom. on Econ. Stab.	Cost Accounting Standards Board - Std. 409
	Financial Acctg. Standards Board	
8 Jan 75	"	Acctg. for contingencies
10 Mar 75	"	Extinguishment of debt
22 Apr 75	"	Foreign currency translation
22 Sep 75	"	Purchasing power reporting
24 Oct 75	"	Leases
25 Nov 75	"	Leases
5 Dec 75	"	Marketable securities
17 Dec 75	"	Segment reporting
15 Jan 76	"	Employee benefit plans
8 Mar 76	"	Materiality
	American Inst. of CPA's	
15 May 75	"	Int. Acctg. Stds. Board
23 Jun 75	"	Gen. acceptable acctg. princ. applied to small bus.
14 Aug 75	AICPA	IASC - Disclosure
14 Aug 75	AICPA	IASC - Depreciation
23 Apr 76	AICPA	IASC - Changing prices
	Securities & Exchange Commission	
10 Mar 75	"	Interim reporting
3 Jun 75	"	Alternative proposal re interim reporting
24 Jun 75	"	Forecasts
23 Jan 76	"	Replacement cost disclosure

	Cost Accounting Standards Board	
5 Feb 75	"	Allocation of G & A expenses
20 Feb 75	"	Acquisition cost of material
1 Apr 75	"	Deferred compensation
1 Apr 75	"	Direct & indirect costs
22 Apr 75	"	Termination
30 Jun 75	"	Cost of capital
11 Jul 75	"	Pension costs
1 Aug 75	"	Costs of service centers
5 Sep 75	"	Alloc. of mfg. overhead
9 Jan 76	"	Alloc. of G & A expenses
9 Jan 76	"	Depreciation inflation adjustment
28 Jan 76	"	Direct & indirect costs
12 Mar 76	"	Deferred compensation
7 Apr 76	"	Interpretation No. 1
23 Apr 76	"	Cost of money
23 Apr 76	"	Service centers
23 Apr 76	"	Insurance costs

sg/4/1

National Association of Accountants

919 THIRD AVENUE
NEW YORK, N Y 10022
212 / 759 3444

June 30, 1975

Mr. Paul R. McClenon, Project Director
Cost Accounting Standards Board
441 G Street, NW
Washington, D.C. 20548

Dear Mr. McClenon:

This letter is a belated response to your letter of March 10th in which you asked for submission of our informal reactions and suggestions with respect to the accounting and economic concepts involved in the issues/questionnaire relating to Cost of Capital. The Subcommittee on Responses to the Cost Accounting Standards Board of the Management Accounting Practices Committee of the National Association of Accountants is pleased to submit its response, herewith.

The Subcommittee welcomes the Board's concern with the Cost of Capital. DOD efforts to consider contractors' investments as a factor in profit determination, as set forth in Defense Procurement Circular 107 (hereinafter referred to as DPC 107), have been generally described as a failure. This disenchantment with DPC 107 has been evidenced by both those in government and in industry. It would appear reasonable to attribute the difficulties encountered in the DPC 107 approach to either or both the calculation of the capital base or the determination of the profit rate to be applied to the capital base and possibly to the complexity of the methodology employed. While the methodology is admittedly not simple, were DPC 107 to provide rewards for compliance therewith, it probably would have been better received. The current CASB approach deviates from the rate determination involved in DPC 107 in that the rate now contemplated to be applied to the capital base consists solely of the reward attributed to risk free capital. However, the capital base determination is almost identical to that of DPC 107. Under these circumstances, it would seem incumbent upon the CASB to seek to ascertain what faults are inherent in DPC 107 lest its efforts likewise result in a failure. For reasons which will be detailed later, the Subcommittee's view is that the faults therein relate to both the determination of the capital base and the selection of the applicable rate.

Before turning to detailed observations of the Subcommittee, some comments regarding policy are in order.

The Subcommittee's greatest disagreement with the CASB proposed approach is found in the determination to use book values in the measurement of facilities capital. Certainly the loss in units of purchasing power in the capital recovery is patent. Understandably, the CASB may prefer to avoid taking the lead in recognizing the capital erosion which is inherent in the retention of the use of historical costs. To the extent that this loss in purchasing power is currently being recognized it is through a higher profit rate. The CASB's determination not to recognize this loss appears to be a new pronouncement upon the merits of the issue and may serve to deter current efforts by the procurement agencies to cope with this problem. The relegation of this most important problem to merely a factor in the determination of overall profit is purely makeshift and infinitely less satisfactory than a straightforward approach to the restatement of historical costs.

It would appear axiomatic that the total profit to be obtained by the CASB's determination of what constitutes a payment for the utilization of risk free capital and the procuring agencies payment for risk assumption should provide an adequate return. The United States Supreme Court has defined an adequate return as "an amount that would enable the company to operate successfully, to maintain its financial integrity, to attract capital and to compensate its investors for risk."

The CASB, by taking the lead in concern over the cost of risk free capital would appear to have constrained the Executive Branch agencies to solely that of determining how to compensate a seller for his assumption of risk. To achieve any semblance of an adequate return, one would assume that the two approaches to the determination of profit would have to interleaf and be coordinated with each other. Were both the base and the applicable rate to be determined by different and unrelated methods, there could only be confusion as to the capital employed and its method of reward with no assurance that the combined reward would be adequate. Lacking knowledge of how reward for risk capital is to be calculated it is impossible to form any opinion with respect to the vital issue--adequacy of overall return.

Since the return for the utilization of risk free capital is an integral part of profit and the latter is a major determinant in the allocation of resources in a free market, the CASB approach involves its determination of those who will be available for satisfying government procurement needs. This conclusion is based on the assumption that any deficiencies in the CASB approach to providing a reward for the risk free use of capital must stand and would be immune to alteration by the procurement agencies later involved. A change of this magnitude in the procuring agencies' inherent

responsibility to maintain a healthy supply base surely is deserving of an impact study to determine in advance whether the implementation of this policy will have the effect the CASB desires and anticipates.

The Subcommittee is gravely concerned with the implications of government interest in rates of return in competitive situations. Past experience discloses that "desired rates" are generally taken as those to be attained only under the most optimal of conditions. Consequently, almost all dispersion of rates of return in regulated industry experience lies below the so called "desired rates." Further, the "desired rates" themselves seem static and impervious to change in unison with changes in the environment. The setting of rates has occurred on a year by year basis with little or no regard to the cumulative experience. How this tendency will color the cost of capital consideration in practice is, of course, unknown. However, there appears to be no improvement over past practice in this regard. In fact, there is a regression. It seems unlikely that today's contractors will fare any better than the experience of the Pennsylvania Railroad which only once in all of its years of operations achieved the Interstate Commerce Commission's desired rate of return. The Subcommittee concludes that there is considerable risk to government contractors in this process of partial profit determination.

Finally, with respect to policy, the Subcommittee believes that if capital is to be retained by contractors and be available at competitive costs as needed, their capital must be measured by the right hand, or liabilities and stockholders equity side of the balance sheet in terms of capital in hand rather than on the left hand, or asset side of the balance sheet in terms of capital employed. This is particularly true of the large order cyclical contractors who must retain capital in down periods because they know it must be on hand to insure any upside. The history of rate regulation displays an original concern over assets employed, but this approach in no way met the Supreme Court's definition of an adequate profit. Hence, there has been a general trend to determining capital at risk by reference to the "right hand" side of the balance sheet. Rate regulatory authorities have realized that debt increments must be supported by additions to equity and that growth cannot be achieved unless there is a market for equity capital at a competitive cost as needed. It must be stressed that while this may be practical in monopolistic or near monopolistic situations, in other situations it may lead to what alternatively may be described as either duplication of capital or the retention of competition and a desired level of a production base. There should be little doubt that neither a straight capital employed basis or a capital on hand basis are proper measures of capital at risk. Some rational basis for the determination of an interim point must be developed . Over concern with capital employed has led to an overreach on the negative side through an inadequate consideration of capital needs.

Turning to comments which more specifically deal with details, the Subcommittee is concerned with several points.

The first relates to the projection of the cost of risk free capital which will be required for use in multi-year contracts. If there is an existing organization that can control the availability of capital in terms of supply and demand, it is the United States Government. The availability of capital will certainly affect the rate of risk free capital . Such negotiations as may be necessitated with respect to projected rates will be almost solely dependent on representations made by government representatives. Considering that rates are temporal and geared to national policy considerations it seems most unlikely that there will be any correlation between those in good faith projected by the government and what will actually occur in practice. This exposure to rate negotiation by government fiat is hardly likely to improve the relations between buyer and suppliers.

Point two concerns the Subcommittee's belief that there are serious shortcomings in the DPC 107 approach of determining capital employed. Complaints have centered on the fact that it favors capital intensive industries. However, a more critical examination of the facts discloses that the causative factor lies in the under calculation of operating capital.

The measurement of facilities capital appears, with two exceptions, to be satisfactory. One of these concerns the reliance upon historical costs which has been commented upon previously. The other concerns the treatment accorded to the construction of facilities in progress. The interest cost related to such construction should be capitalized.

The Subcommittee believes that the measurement of operating capital is quite deficient. This deficiency is apparently founded in the belief that capital may be acquired, retained and disposed of at no material cost. Consideration of this assumption in any depth will disclose that it is simply not true. Instead, capital must be acquired and retained within bands of anticipated needs. And, such capital while held, must earn a reasonable return. The proposed calculation of operating capital closely approximates a determination of that capital which will be required under the most optimal conditions. It contains no provision for standby capital that is required to cover contingencies. It assumes that deviations from planned cash flows are virtually non existent. This assumption is at odds with all experience. It is generally known that capital must be on hand to protect an organization from strikes, slowdowns, extended lead times, shortages, catastrophes and acts of God. Only by such capital reserves

can insolvency and even bankruptcy be avoided. As an aside, it should be noted that only through the existence of such capital can a contractor fulfil his obligations upon a contract on which a loss is being experienced. The measurement process does not even include such compensating balances that may be required in support of bank borrowings. The Subcommittee concludes that the impact of this approach to the measurement of operating capital can only in the end lessen its availability.

In presenting the above, we have chosen not to iterate the comments of others in their letters to you. Instead, the Subcommittee has endeavored to point out the most critical issues. There is no issue more vital today for those who serve the government as suppliers than the necessity for obtaining an adequate rate of return. Our adverse criticism should in no way be construed as an indication of any fundamental objection to the recognition of cost of capital. Rather, it represents an attempt to provide some constructive suggestions because we are well aware of the fact that an improper approach to this subject may unwittingly do more harm than good. We trust that the CASB will be able to make a good start on correcting an intolerable situation.

Should you have any questions concerning the foregoing, please contact the undersigned at AC 213 station 990-8269 by telephone or by writing to 3800 Royal Woods Drive, Sherman Oaks, Ca. 91403.

Sincerely,

Dudley E. Browne (BB)

Dudley E. Browne
Subcommittee on Responses
to the Cost Accounting Standards
Board
Management Accounting Practices
Committee

DEB/pl

National Association of Accountants

William M. Young Jr. ...
919 THIRD AVENUE
NEW YORK, N.Y. 10022
(212) 754-9700

July 16, 1975

Mr. Joseph J. Jasinski
Staff Director
Subcommittee on Economic Stabilization of the
Committee on Banking, Currency, and Housing
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Jasinski:

With reference to your letter of May 23, 1975, in which you requested comments on Cost Accounting Standard No. 409, Depreciation of Tangible Capital Assets, we are pleased to respond.

The Management Accounting Practices (MAP) Committee is the group authorized to speak for the National Association of Accountants (NAA) on matters affecting accounting principles and practices. As you note in your letter, NAA published its Statement No. 7, which was the MAP Committee's position on Depreciation as it relates to financial reporting. Through a subcommittee designated for Cost Accounting Standards Board (CASB) liaison purposes, the MAP Committee, on November 20, 1974, submitted a comment letter on the then-proposed Standard to the CASB. I enclose a copy of that comment letter.

As will be evident to you upon reading the attachment, the pervasive theme of the remarks is the potentially damaging impact that may result from promulgation of the Standard. In the view of the MAP Committee, the issue of economic impact is sometimes crucial with respect to rulings of Standard-setting bodies, and one which should not be ignored. The committee is not concerned with consistency when considering reporting models with divergent functions. To illustrate, a position of advocacy for straight-line depreciation in financial reporting is not in conflict with regret over regulations which would likely restrict the use of a capital recovery incentive such as accelerated depreciation.

Proceeding further along the same lines, we might express a few other points. According to Standard 409, the CASB is willing to accept what actually appears to be the situation as to service lives and the rate of asset consumption. We think that embodied within the Standard is the tacit assumption that management has free will regarding the determination of asset purchase and retirement policy. However, loss companies do not generate the positive cash flows necessary to maintain sufficiently modern equipment. For example, the plight of the Penn Central Railroad might be described as an ever-lengthening of that railroad's service life. There is

no way a loss company faced with its operating problems can avoid going down-hill.

Faced with the political limitations on profits, procurement agencies have determined the levels of participation of defense producers by increasing or decreasing the allowability of costs. With the CASB having taken charge of cost allowability, procurement agencies are limited to profit percentage variability for motivation purposes. They are unlikely to be responsive to the challenge. Past motivating techniques such as rapid writeoff, shortening lives and redefining allowable costs no longer are available. The problem is compounded by the inability to compensate for capital erosion through inflation by the requirements of historical-cost based pricing.

We thank you for the opportunity to comment on CAS No. 409 and hope our remarks, although submitted later than requested, are of value.

Sincerely yours,

Allan C. Crane

Allan C. Crane
Chairman
Management Accounting
Practices Committee

ACC/pl
Enclosure

National Association of Accountants

William M. Young, Jr., *Executive Director*
919 THIRD AVENUE
NEW YORK, N Y 10022
212 / 759 3444

April 23, 1976

Mr. Arthur Schoenhaut, Executive Secretary
Cost Accounting Standards Board
441 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Schoenhaut:

The Subcommittee on Responses to the Cost Accounting Standards Board of the National Association of Accountants' Management Accounting Practices Committee is pleased to submit, herewith, its comments upon the proposed Cost Standard 4 CFR Part 414, "Cost of Money as an Element of the Cost of Capital."

We would observe that inflation affects three components of cost: (1) the cost of risk free capital; (2) the risk premium in capital cost and (3) the current cost of physical resources used.

The proposed cost standard applies solely to the first of these, the cost of risk free capital. No one should be misled into thinking it applies to the other two. The statements in the preamble could be interpreted in that way.

The main difficulty with the proposed cost standard is that some may attempt to equate contract price to cost, on the ground that the cost of capital is already included. Such an attempt would ignore completely (1) the risk premium in the cost of capital; (2) the income tax on the imputed cost of capital allowed by this proposed standard and (3) the impact of inflation on replacement cost. If the proposed standard is adopted, it sould be made clear that these factors must be allowed in contract price. In the absence of a clear statement to this effect, the proposed cost standard should be withdrawn.

It is not clear whether the cost of money will be considered as an added cost upon which profit is to be added or whether this will be utilized to lower existing profit margins.

The Board is to be commended for the simplification of the techniques to be used in the measurement and allocation of the cost of capital.

Should you have any questions regarding the above,

please direct them to the undersigned who may be reached by telephone at (213) 990-8269 between the hours of 9:30 and 11:00 am, EST or by letter to 3800 Royal Woods Drive, Sherman Oaks, California 91403.

Yours truly,

Dudley E. Browne

Dudley E. Browne, Chairman
Subcommittee on Responses to the
Cost Accounting Standards Board
Management Accounting Practices Committee
National Association of Accountants

deb[2]

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

2 April, 1976

Mr. Paul Gerhardt
Administrative Secretary
American Accounting Association
653 South Orange Avenue
Sarasota, Florida 33577

Dear Mr. Gerhardt:

As part of its accounting responsibilities, this subcommittee is studying the activities of the Financial Accounting Standards Board (FASB) in setting accounting standards upon which certain Federal agencies rely. The 1974 annual report of the FASB and the Financial Accounting Foundation states:

> The Board of Trustees of the Foundation consists of nine Trustees. In essence, Trustees are selected from nominations by five organizations, usually referred to as sponsoring organizations. These sponsoring organizations, each of which has a continuing interest in financial reporting, are:
>
> - American Accounting Association
> - American Institute of Certified Public Accountants
> - Financial Analysts Federation
> - Financial Executive Institute
> - National Association of Accountants
>
> The Trustees rely heavily on the help of the sponsoring organizations in raising the

required funds each year, for the recommendation of qualified candidates for appointment to the Standards Board and the Advisory Council, and for suggestions as to how the primary purpose can best be achieved. The Standards Board also receives valuable research assistance from the sponsoring organizations.

This subcommittee needs some basic information on the groups sponsoring the FASB in order to evaluate the relationship between the FASB and Federal agencies. In view of your organization's role in supporting the FASB, please provide the following information to the subcommittee.

1. Copies of any reports your organization may have developed for each of the past three years.

2. The amounts contributed directly or indirectly by your organization to the Financial Accounting Foundation and the Financial Accounting Standards Board in each year since their inception.

3. The identity and business affiliations for each of your organization's members serving on the Financial Accounting Standards Board, the Financial Accounting Standards Advisory Council, or as a trustee of the Financial Accounting Foundation.

4. A brief description of the purpose and activities of your organization.

5. A brief description as to the number and primary busienss affiliations of your organization's members.

6. The tax status of your organization.

7. A copy of the latest budget showing amounts and sources of revenues and expenditures.

Your cooperation is appreciated.

Very truly yours,

ORIGINAL SIGNED BY
LEE METCALF

American Accounting Association

653 S. Orange Avenue
Sarasota, Florida 33577

Paul L. Gerhardt, Administrative Secretary • Telephone 958-2711 (Area 813)

April 29, 1976

Mr. Lee Metcalf
Committee on Government Operations
Subcommittee on Reports, Accounting
and Management
United States Senate
Washington, D. C. 20510

Dear Mr. Metcalf:

This will acknowledge receipt of your letter to me dated April 2, 1976. I am pleased to provide you with the information requested in your letter. In your letter you requested copies of any reports the American Accounting Association may have developed for the FASB during the past three years. Copies of these reports are enclosed. Please note that in all of these reports the statements by AAA committees or subcommittees are not offical expressions of the American Accounting Association. The statements reflect the thinking of a majority of members of the committee and, as such, may be representive of academic thought on the topic, but have not been passed upon by the Association's Executive Committee or its membership.

The amounts contributed by the American Accounting Association include $5,000.00 in 1973, $5,000.00 in 1974 and $6,876.00 in 1975. It is the Association's present policy to contribute $2.00 per teaching member of the Association who resides in the United States. This accounts for the $6,876.00. A similar type of contribution will be made next fall.

The American Accounting Association appoints one trustee to the Financial Accounting Foundation. Our present trustee is Dr. James Don Edwards, Professor of Accounting at the University of Georgia. There are undoubtedly other people serving on the Financial Accounting Standards Board and Financial Accounting Standards Advisory Council who are members of the American Accounting Association. They are not, however, appointed by the Association and I, therefore, have no official listing of them.

Item #4 of your request was for a brief description of the purpose and activities of the American Accounting Association. The objectives of the Association are to initiate, encourage, and sponsor research in accounting and to publish or aid in the publication of the results of research; to advance accounting instruction and to encourage qualified individuals to enter careers in the teaching of accounting; to advance and develop an application of accounting concepts and standards and seek their adoption for financial statements prepared for external purposes; to advance the development and uses of accounting for internal management purposes; and to advance a widespread knowledge of accounting among qualified students and the public generally. The Association sponsors research in accounting and frequently publishes

the results of this research, publishes a quarterly journal entitled "The Accounting Review", the Association actively awards scholarships and fellowships to accounting students, and members of the Association are eligible to attend various continuing education and workshops which are sponsored by the Association.

In your letter, you also requested a brief description as to the number and primary business affiliations of our members. The American Accounting Association has approximately 12,000 members. Of this amount, about 10,000 reside in the United States. At the present time, approximately 4,500 of those 10,000 are accounting professors at universities and colleges throughout the country. The remaining 5,500 are probably connected through the accounting profession through employment in industry, government, or CPA firms. We do not have a breakdown of our members' business affiliations with which I could provide you.

The American Accounting Association is a 501(c)(3) organization. In response to request #7 in your letter, I have enclosed a copy of the January, 1976 issue of our newsletter, "Accounting Education News". This newsletter contains our most recent financial report for our 1974-75 fiscal year. I trust my comments have provided the information requested in your April 2 letter. If you need more information or clarification of any of my comments, please do not hesitate to call upon me.

Very truly yours,

American Accounting Association

Paul L. Gerhardt
Administrative Secretary

PLG:ch
Enclosures

ARTHUR ANDERSEN & CO.
CERTIFIED PUBLIC ACCOUNTANTS
TAMPA, FLORIDA 33602

To the Executive Committee,
American Accounting Association:

We have examined the balance sheet of AMERICAN ACCOUNTING ASSOCIATION (an Illinois corporation, not for profit) as of August 31, 1975 and 1974, and the related statements of revenues and expenses and changes in fund balances and contributions received for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements present fairly the financial position of American Accounting Association as of August 31, 1975 and 1974, and the results of its operations and changes in its fund balances for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

Arthur Andersen & Co.

Tampa, Florida,
September 23, 1975

STATEMENT OF CONTRIBUTIONS RECEIVED
FOR THE YEARS ENDED AUGUST 31, 1975 AND 1974

	1975	1974
GENERAL FUND		
Touche Ross Foundation (Robert M. Trueblood Seminars)	$ 40,000	$ –
Haskins & Sells Foundation (Doctoral Consortiums)	20,000	20,000
Exxon Corporation	3,000	
Caterpillar Tractor Company	1,000	1,000
American Accounting Association member	900	
Total Contributions to General Fund	$64,900	$21,000
PUBLICATIONS FUND		
Ernst & Ernst Foundation	$ 24,457	
FELLOWSHIP FUND		
Ernst & Ernst Foundation	$ 5,000	$ 5,000
Haskins & Sells Foundation	5,000	5,000
Lybrand Foundation	5,000	5,000
Arthur Young Foundation	3,000	3,000
Touche Ross Foundation		3,000
Main Lafrentz & Co	1,000	1,000
Uniroyal, Inc.	1,000	1,000
IBM Corporation	500	500
South-Western Publishing Company	500	500
Hurdman and Cranstoun	-	500
American Accounting Association members and others	3,463	3,339
Total Contributions to Fellowship Fund	$ 24,463	$27,839
EDUCATIONAL RESEARCH FUND		
Price Waterhouse Foundation	$ 40,000	$15,000
Total Contributions Received	$153,820	$63,839

The accompanying notes are an integral part of this statement

NOTES TO FINANCIAL STATEMENTS

(1) **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

Publications Inventory —

Publications inventory is carried at first-in, first-out cost, which is less than current selling prices.

Basis of Revenue and Expenses Recognition —

Dues are deferred initially and amortized to income in the applicable membership period. Subscription revenues are reflected in income when publications are issued. Contributions are recognized as income when received. Expenses for publishing the *Committee Reports Supplement* to *The Accounting Review* are accrued in the year the committees meet. Research project expenses related to projects authorized by the Director of Research and Director of Education are accrued in the year the projects are authorized.

Office Furniture and Equipment —

Depreciation of office furniture and equipment is provided on the straight-line method, with estimated useful lives ranging from 4 to 10 years.

(2) **FUND PURPOSES:**

General Fund —

The General Fund is used to account for the primary operations of the Association, as well as those operations and activities not accounted for in specially designated funds.

Investment Fund —

This fund reflects the revenues generated by long-term investments of the Association's funds and the disposition thereof.

It is Association policy to transfer an amount to the General Fund each year equivalent to 5% of the average market value of these investments for the three preceding years.

Publications Fund —

This fund was established to record the sale of publications of the Association other than *The Accounting Review* and publications funded specifically by other funds such as *Researching the Accounting Curriculum: Strategies for Change*, which is funded by the Educational Research Fund.

It is Association policy to maintain the balance of the Publication Fund at $30,000 or the amount of the inventory value, whichever is higher. Any excess over this balance is transferred to the General Fund unless otherwise approved by the Executive Committee.

Fellowship Fund —

This fund was established to record the operations of the fellowship program. Fellowships are awarded using funds generated by contributions to this fund.

Educational Research Fund —

This fund was initially established by the Executive Committee to account for receipts and expenditures of funds related to the Price Waterhouse Foundation research project and will be utilized for similar projects in the future.

(3) **THE ASSOCIATION:**

The American Accounting Association is exempt from income taxes under Section 501(c)(3) of the U. S. Internal Revenue Code and has been determined to be an educational organization which qualifies contributions to the Association for a charitable contribution deduction.

(4) **COMMITMENTS:**

The Association's lease of office space provides for annual rentals of approximately $6,000 to September 30, 1977.

(5) **PENSION PLAN:**

On April 30, 1975, a non-contributory pension trust was adopted which covers substantially all employees. This trust was established to replace the trust adopted on June 3, 1972. The Association's policy is to fund pension costs accrued. Pension expense for the years ended August 31, 1975 and 1974, was approximately $3,700 and $2,350. There are no unfunded past service costs.

BALANCE SHEET

August 31, 1975 and 1974

ASSETS	General Fund	Investment Fund	Publications Fund	Fellowship Fund	Educational Research Fund	1975 Total	1974 Total
Cash	$ 16,916	$	$ –	$ –	$ –	$ 16,916	$ 12,230
5% – 7% Certificates of deposit	224,294		–	20,000	-	244,294	197,892
Marketable securities - Mutual funds, at market (cost of $120,018)	–	84,455	–		-	84,455	67,570
Accounts receivable, less allowance of $300 and $200 for doubtful accounts	1,610	-	8,769		364	10,743	8,291
Interest receivable	1,890	–	–	200	–	2,090	2,426
Publications inventory (Note 1)			51,830		2,570	54,400	33,112
Prepaid expenses and other assets	11,774		–	-	–	11,774	6,876
Office furniture and equipment, at cost, less accumulated depreciation of $2,570 and $3,001 (Note 1)	3,527	–	-	–	-	3,527	2,075
Due from (to) other funds	(19,652)	2,771	(8,769)	16,926	8,724	-	
	$240,359	$87,226	$51,830	$37,126	$11,658	$428,199	$330,472

LIABILITIES AND FUND BALANCES

	General Fund	Investment Fund	Publications Fund	Fellowship Fund	Educational Research Fund	1975 Total	1974 Total
LIABILITIES:							
Accounts Payable	$ 27,918	$ -	$ -	$ –	$ –	$ 27,918	$ 13,433
Accrued expenses	28,319	–	–	–	434	28,753	18,445
Advance collections (Note 1) –							
Membership dues	75,596	–	–	–	–	75,596	75,244
Subscriptions	27,218	.	–	–	–	27,218	25,609
Total liabilities	$159,051	–	–	–	$ 434	$159,485	$132,731
FUND BALANCES:							
Designated for –							
Community college workshops	$ 9,844	$ –	$ –	$ –	$ –	$ 9,844	$ 15,000
Continuing education	–	–	–	–	–	–	6,345
Committee on Developing Countries	–	—	–	–	-	–	1,180
Fund purpose (Note 5)	–	87,226	51,830	37,126	11,224	187,406	149,903
Undesignated, available for general activities	71,464	-	–	–	-	71,464	25,313
Total fund balances	$ 81,308	$87,226	$51,830	$37,126	$11,224	$268,714	$197,741
	$240,359	$87,226	$51,830	$37,126	$11,658	$428,199	$330,472

The accompanying notes are an integral part of this oalance sheet

STATEMENT OF REVENUES AND EXPENSES AND CHANGES IN FUND BALANCES FOR THE YEARS ENDED AUGUST 31, 1975 AND 1974

	General Fund	Investment Fund	Publications Fund	Fellowship Fund	Educational Research Fund	1975 Total	1974 Total
REVENUES (Note 1):							
Membership dues	$261,917	$ –	$ –	$ –	$ –	$261,917	$239,468
Subscriptions	69,843	–	–	–	–	69,843	59,550
Advertising	27,290	–	–	–	-	27,290	17,930
Publication sales	6,346	–	58,185	–	1,465	65,996	47,498
Contributions	64,900	–	24,457	24,463	40,000	153,820	63,839
Interest and dividend income	11,775	4,020	–	1,209	–	17,004	15,789
Increase in market value of securities	-	16,885	–	–	–	16,885	–
Other	32,787	–	–	–	-	32,787	15,624
	$474,858	$20,905	$82,642	$25,672	$41,465	$645,542	$459,698
EXPENSES:							
Cost of publications –							
The Accounting Review	$118,481	$ –	$ –	$ –	$ –	$118,481	$ 96,140
Committee Reports Supplement (Note 1)	12,630	–	–	–	–	12,630	23,737
Other	–	–	47,529	–	6,109	53,638	9,870
Education	10,473	–	–	–	-	10,473	29,626
Research	19,643	-	–	-	–	19,643	16,042
Committees	49,637	–	–	–	-	49,637	56,992
Educational Research Consortium	26,138	–	–	–	–	26,138	16,110
Officers' meetings and administration	49,116	–	–	–	–	49,116	39,620
Administration	107,844	–	–	-	31,340	139,184	88,317
Financial Accounting Foundation contribution	5,000	–	–	-	–	5,000	5,000
United Student Aid Fund	10,000	–	–	–	–	10,000	–
Other programs and seminars	53,179	–	–	-	.	53,179	-
Fellowship grants	–		–	27,450	–	27,450	33,650
Decrease in market value of securities	-	–	–	–	–	–	23,671
	$462,141	$ –	$47,529	$27,450	$37,449	$574,569	$438,775
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES BEFORE TRANSFERS	$ 12,717	$20,905	$35,113	$(1,778)	$ 4,016	$ 70,973	$ 20,923
TRANSFERS TO GENERAL FUND (Note 2)	20,753	(4,358)	(16,395)	-	–	–	–
	$ 33,470	$16,547	$18,718	$(1,778)	$ 4,016	$ 70,973	$ 20,923
FUND BALANCE, beginning of year	47,838	70,679	33,112	38,904	7,208	197,741	176,818
FUND BALANCE, end of year	$ 81,308	$87,226	$51,830	$37,126	$11,224	$268,714	$197,741

The accompanying notes are an integral part of this statement.

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

2 April, 1976

Mr. T. R. Lilley
President
Financial Analysts Federation
219 East 42nd Street
New York, New York 10017

Dear Mr. Lilley:

As part of its accounting responsibilities, this subcommittee is studying the activities of the Financial Accounting Standards Board (FASB) in setting accounting standards upon which certain Federal agencies rely. The 1974 annual report of the FASB and the Financial Accounting Foundation states:

> The Board of Trustees of the Foundation consists of nine Trustees. In essence, Trustees are selected from nominations by five organizations, usually referred to as sponsoring organizations. These sponsoring organizations, each of which has a continuing interest in financial reporting, are:
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> - American Accounting Association
> - American Institute of Certified Public Accountants
> - Financial Analysts Federation
> - Financial Executive Institute
> - National Association of Accountants
>
> The Trustees rely heavily on the help of the sponsoring organizations in raising the required funds each year, for the recommendation of qualified candidates for appointment to the Standards Board and the Advisory Council, and for suggestions as to how the primary purpose can best be achieved. The

Standards Board also receives valuable research assistance from the sponsoring organizations.

This subcommittee needs some basic information on the groups sponsoring the FASB in order to evaluate the relationship between the FASB and Federal agencies. In view of your organization's role in supporting the FASB, please provide the following informationtto the subcommittee.

1. Copies of any reports your organization may have developed for each of the past three years.

2. The amounts contributed directly or indirectly by your organization to the Financial Accounting Foundation and the Financial Accounting Standards Board in each year since their inception.

3. The identity and business affiliations for each of your organization's members serving on the Financial Accounting Standards Board, theFinancial Accounting Standards Advisory Council, or as a trustee of the Financial Accounting Foundation.

4. A brieffdescription of the purpose and activities of your organization.

5. A brief description as to the number and primary business affiliations of youroorganization's members.

6. The tax status of your organization.

7. A copy of the latest budget showing amounts and sources of revenues and expenditures.

Your cooperation is appreciated.

Very truly yours,

ORIGINAL SIGNED BY
LEE METCALF

The Financial Analysts Federation

Tower Suite, 219 East 42nd Street, New York, N. Y. 10017, (212) 557-0055

Mildred M. Hermann
Corporate Secretary

Direct Dial:
(212) 557-0050

April 28, 1976

Senator Lee Metcalf
Chairman, Subcommittee on Reports,
Accounting, and Management
Washington, D.C. 20510

Dear Sir:

Thank you for asking us to provide information to the Subcommittee on Reports, Accounting, and Management relating to the activities of the Financial Accounting Standards Board (FASB).

Our response follows the numbering and order of your questions:

1. Reports. Copies of reports about the FASB provided to our membership through our Newsletter during the past three years are attached as Exhibits A, 1-13.

2. Contributions. The Financial Analysts Federation has given $7,000 directly to the FASB (our fiscal 1975-76). Indirectly the Federation has provided $195,625 to the FASB as the direct result of a fundraising campaign during the year 1973 on behalf of the FASB. FAF members serve without recompense on FASB task forces and respond in detail to most FASB discussion memoranda and exposure drafts.

3. Membership Serving FASB Bodies. The following persons serve as trustees of the FASB and as Advisory Council members:

Trustee:	Walter P. Stern, CFA, Senior Vice President Capital Research Co., New York
Advisory Council:	William C. Norby, CFA, Senior Vice President Duff & Phelps, Inc., Chicago
	David Norr, CFA, CPA, Partner First Manhattan Co.
	Frances G. Stone, CFA, Vice President Merrill Lynch, Pierce, Fenner & Smith Inc., New York

4. FAF Purposes. The purposes of the Financial Analysts Federation as stated in the Articles of Incorporation are to:

   ...provide the member societies, the members of such societies, the individual members of the corporation, and the general public with information, knowledge, and understanding of sound and trustworthy principles, practices, and conduct with regard to investment and financial management...to encourage and aid the education of persons engaged in the profession of financial analysis...to develop, promulgate and enforce a Code of Ethics and Standards for persons practicing the profession of financial analysts; and to carry on, sponsor, aid, and encourage research and educational and informational activities....

   FAF Activities. As the professional organization for a professional with bi-national as well as international membership and relationships, the Federation provides a variety of services. See Exhibit B, for a listing and description.

5. Membership. Forty-eight financial analysts societies in the U.S. and Canada (44 and 4 respectively) are members of the Federation. There are about 14,000 members of the societies. Of that total about 4,400 (32%) are employed with broker/dealers; 3,400 (24%) with investment advisory firms and investment companies; about 3,200 (23%) with commercial banks; and about 1,400 (10%) with insurance companies. The remaining 1,600 (11%) are with the following: self-administered pension and endowment funds, academia, government and industrial firms and in miscellaneous categories. Members are typically employed as research analysts or portfolio analysts or are administrators and executives of organizations employing such persons.

   Attached as Exhibit C is a copy of the 1976 Membership Directory of the Federation. The member societies are listed on page 4. The Federation officers and the officers and members of the affiliated societies are also listed, as are the committee memberships, including the Financial Accounting Policy Committee, which Mr. Norby, a member of the FASB Advisory Council chairs, and upon which Mr. Norr and Dr. Stone, FASB Advisory Council members, serve. The Articles and By-Laws are also Included.

6. The Federation is a 501 (c) 6 organization under the Internal Revenue Code of 1954.

7. A copy of the Federation's 1975-76 budget is attached as Exhibit D.

   Please let me know if additional meterial would be helpful.

Sincerely,

MMH:dln
Enclosures

Exhibit B

STATEMENT BY FINANCIAL ANALYSTS FEDERATION REGARDING ITS ACTIVITIES

The Financial Analysts Federation is the professional organization of more than 14,000 financial analysts primarily engaged in the profession of investment management.

Among its activities are the following:

EDUCATIONAL--Each year the Federation holds an annual and a fall conference, where attendance averages 800-1,000 and 400-500 respectively. These three-day conferences feature speakers and panelists drawn from the profession, business, academia, and government. Topics are drawn from the interface among government, economics, and investments; significant developments in fields such as accounting; the investment outlook for individual industries; regulation; and portfolio strategy. A current conference announcement is attached.

In addition the Federation sponsors symposia and seminars on topics of timely importance to the profession. Attendance ranges from 50 to 300. Examples of such meetings held during the past year include a seminar in Phoenix on "Critical Issues Facing the Investment Industry Today," the Sixth Annual Bank Industry and Bank Stock Symposium in New York, a Southeast Banking Symposium in Charlotte, an Insurance Seminar in Hartford, and a seminar co-sponsored with the Financial Analysts Research Foundation, the ICFA and the American Banking Association and titled "Evolving Concepts of Prudence: The Changing Responsibilities of the Investment Fiduciary in the Age of ERISA" in New York, and a seminar on multi-divisional corporations, also in New York.

The Federation holds three formal study programs each year. In cooperation with the Graduate School of the University of Chicago, the Federation conducts a one-week concentrated study of security and economic analysis for financial analysts. About 160 Federation members attend each year. In cooperation with the Graduate School of Business Administration of Harvard University, the Federation holds a week-long workshop for experienced portfolio managers and executives. Attendance at the Harvard Workshop is limited to 100. A three-day Canadian Investment Seminar, which concentrates on economic, political, and investment topics from the point of view of the Canadian investor, is held annually at the University of Western Ontario, with attendance approximating 40.

INTERNATIONAL--The Federation is a founding member of the International Coordinating Council, a vehicle for ongoing communication and coordination of analysts' concerns and interests on six continents. Major topics of mutual interest include: education for analysts, professional standards, regulation in the investment field, harmonization of accounting principles, and coordination of disclosure policies.

The Canadian Council is the arm of the Federation which relates to concerns of particular importance to the profession in Canada. The Council's efforts include liaison with Canadian provincial and federal securities officials, participation in development of accounting standards through the Canadian Institute of Chartered Accountants, and development of educational programs to advance the profession in Canada.

PUBLIC POLICY--The Federation's officers, staff, and committees study and comment upon questions of public policy through participation in hearings and task forces and the preparation of position papers. Recent examples

include comments to both the Financial Accounting Standards Board and the SEC, respectively, on price level and replacement cost accounting, participation in the FASB's task forces on Accounting and Reporting for Employee Benefit Plans and Financial Accounting and Reporting in the Extractive Industries, and responses to the SEC's releases on Accounting for Environmental Issues.

PUBLICATIONS--The Federation publishes the bi-monthly magazine, Financial Analysts Journal, which is edited for professional investors, including managers of pension, endowment, mutual and trust fund portfolios, partners and officers of investment and security firms and financial analysts. Articles report new developments in international monetary problems, the structure of the securities industry, fiscal and monetary policy, portfolio selection, security evaluation and public policy issues in corporate reporting and disclosure, in addition to studies of specific industries and a column on securities law and regulation. Other publications include an annual membership directory, bi-monthly Newsletter, occasional monographs and special studies, as on disclosure of corporate forecasts to the investors and reports of evaluation of the FAF Corporate Information Committee.

LOCAL ACTIVITIES--The local societies of the Federation carry on a number of educational activities as well. The societies serve as a means for maintaining an ongoing dialogue between corporations and the investor. The luncheon meetings, seminars, conferences, field trips and symposia sponsored by the local societies also serve as vehicles for educating the membership on the current state of knowledge within the profession and for improving the practice of the profession. Meeting schedules vary by society from one or more daily held by the 4,800 member New York Society of Security Analysts to 8-10 a year held by some of the smaller societies.

QUALIFYING EXAMINATIONS--In 1959 the Federation founded the ICFA to establish standards of professional competence in the field of financial analysis, to conduct tests of competence and to award the professional designation of "Chartered Financial Analyst" (C.F.A.) to those passing the rigorous examinations and requirements. There are presently over 4,100 Chartered Financial Analysts who have successfully completed the three-year examination program. Accounting is a major element in the study and examination program.

Although the ICFA is now an independent entity, the two organizations continue to work together closely. Each organization is represented on the other's Board. In addition, membership in a Federation society is required for completion of the CFA examination program. Standards of Professional Conduct are virtually identical for the two organizations and, when a question of discipline involves a person who is both a CFA and a Fellow of the Federation, provision is made for the coordination of disciplinary proceedings. After July 1, 1976, all new regular members of any affiliated society must have passed the first CFA examination.

67-159 O - 77 - 78

THE FINANCIAL ANALYSTS FEDERATION

SCHEDULE OF
INCOME AND EXPENSES BY ACTIVITY CENTER

EXHIBIT D

	JUNE 30, 1975 ACTUAL	ANNUAL BUDGET 1975-1976
INCOME		
General professional activities	$ 247,814	$ 245,000[1]
Financial Analysts Journal	422,788	363,300[2]
Membership records	118,717	150,000[3]
Conferences and symposia	386,667	463,000[4]
Self-regulation program	83,850	90,000
Round tables and foreign visitations	30,157	65,000[5]
Educational seminars	138,331	145,775[6]
Publication of studies	363	1,000
Total Income	$1,428,687	$1,523,075
EXPENSE (including an allocation of indirect administrative expense)		
General professional activities	$ 159,968	$ 175,000
Financial Analysts Journal	436,956	393,800
Membership records	174,144	150,000[7]
Conferences and symposia	368,882	418,000
Self-regulation program	77,975	90,000
Round tables and foreign visitations	31,365	59,000
Educational seminars	121,157	135,775
Publication of studies	36	500
Total Expense	$1,370,483	$1,432,075
EXCESS OF INCOME OVER (UNDER) EXPENSES BEFORE INCOME TAXES		
General professional activities	$ 87,846	$ 60,000
Financial Analysts Journal	(14,168)	(30,500)
Membership records	(55,427)	---
Conferences and symposia	17,785	45,000
Self-regulation program	5,875	---
Round tables and foreign visitations	(1,208)	6,000
Educational seminars	17,174	10,000
Publication of studies	327	500
	$ 58,204	$ 91,000
Refund of (provision for) income taxes	$ 15,679	$ (15,000)
Excess of income over (under) expenses	$ 73,883	$ 76,000

[1] Based on 14,000 members and uncertain interest rates.
[2] 91 pages advertising and fewer outside subscribers due to natural attrition.
[3] $54,339 @ $40 per copy at 1974 sales rate or $50,000 @ $45 with smaller distribution on basis that only six-months (6) had elapsed since production of the 1975 edition.
[4] 750 New York Conference; 400 Atlanta Conference; 125 Banking Seminar; $55,000 Exhibits.
[5] Five round tables programmed for the coming year.
[6] 102 participants Harvard; 163 participants Rockford.
[7] Tape Production $25,000; Labor $30,000; Overhead $45,000; Printing $40,000; Miscellaneous $10,000.

RG/cp
9/24/75

FAF Newsletter, November 1973

Financial Accounting Committee Reports on Work in Progress

The chairman of the FAF Financial Accounting Policy Committee, Frances Stone, recently reported a number of significant developments in the field.

Several analysts are taking active roles in the work of the task forces of the Financial Accounting Standards Board, which has replaced the Accounting Principles Board.

Included on FASB task forces are:

...Dr. Stone, Merrill Lynch, Pierce, Fenner & Smith, Inc., foreign currency translation;

...William C. Norby, Duff, Anderson & Clark, Inc., diversified corporation reporting;

...Leonard G. Reichhard, Jr., Union Service Corp., reserves for catastrophes;

...David Norr, First Manhattan Co., and Robert Farrell, Bache & Co., accounting for certain costs such as research and development, start-up, and relocation.

Dr. Stone, in summarizing the FASB procedure, stated that "... If we as analysts are to be effective, we must be prepared to comment on FASB exposure material quickly and meaningfully."

Dr. Stone also noted the following:

1. Establishment of an International Committee to relate to the European Federation. This parallels the work of the CPA's who have a group representing eight countries.

2. The publication of an accounting newsletter. Comments and suggestions are requested from all interested parties.

3. The need for suggestions on an education program in accounting for analysts. This program is not to be debits- and credits-oriented but to be geared to the import of accounting treatments.

FINANCIAL ANALYSTS JOURNAL / MAY-JUNE 1974

FAF Accounting Committee Appears at FASB Hearing

The chairman of the FAF's Financial Accounting Policy Committee, Dr. Frances Stone, was one of three committee members to appear at the March 15 public hearing held by the Financial Accounting Standards Board on its discussion memorandum on accounting for research and development and similar costs.

Appearing with Dr. Stone was Frank Block and Theodore R. Lilley. The committee submitted a paper, which included the following points:

1. The most important aspect in considering the expenditure of funds for research and development and similar costs of established operating companies is the uncertainty of the successful completion of any project. The second most important point is the inability to assign direct cost to benefits.

2. All costs, direct and indirect, should be expensed, if they can be attributed to the effort.

3. R and D costs should be explicitly disclosed and not buried in sales or general and administrative costs.

Copies of the FAF paper and, insofar as quantities are available, of the FASB discussion memorandum on R and D, are available from the FAF office.

The FASB also has in circulation discussion memoranda on reporting the effects of general price-level changes, foreign currency losses, and accounting for future losses.

FINANCIAL ANALYSTS JOURNAL / JULY-AUGUST 1974

FAF Responds to Three FASB Memoranda

Working through sub-committees, the FAF's Financial Accounting Policy Committee prepared brief papers and participated in three hearings of the Financial Accounting Standards Board in April, May, and June. Briefly summarized, the FAPC recommended the following positions:

1. ON FUTURE LOSSES—Opposition to recognition of losses or potential losses until they occur or are reasonably certain and opposition to accounting methods which have the effect of smoothing reported earnings.

2. PRICE-LEVEL CHANGES—Different views of rate and duration of inflation led to expression of different opinions. Support by some for FASB effort to determine the desirability of general price-level accounting; opposition by some to price-level adjusted accounting, primarily on grounds of possible confusion to investor and doubt that adjustment would add meaningfully to valuation process.

3. FOREIGN CURRENCY TRANSLATION—Basic emphasis included need for 1) one method of translating foreign currencies; 2) explicit statement of exchange rates; 3) clear indication in statements of gains and losses; 4) prohibition of management forecasts of exchange rate changes and deferred recognition of profits or losses; 5) needed disclosure of rates used, way account is handled, description of any separate accounts used for unusual situations, risk exposure to exchange fluctuations, and footnote disclosure of operating revenues and profits of each operation accounting for 15 percent of sales, income or loss, or assets.

Other FASB News. Discussion memoranda circulated on accounting for segments of business enterprises . . . Task force formed to assist in identifying issues and alternative solutions related to accounting for business combinations and purchased intangible assets. Among task force members are Alfred C. Morley, managing partner, H. C. Wainwright & Co. and C. Reed Parker, executive vice president, Duff, Anderson & Clark, Inc. . . . Exposure draft released of a proposed Statement of Financial Accounting Standards for R&D which would require "that all research and development costs not directly reimbursable by others shall be charged to expense when incurred." If adopted, proposed standards would apply to financial statements for fiscal periods beginning on or after January 1, 1975 and would supersede APB Opinion No. 17 as it applied to R&D costs.

FINANCIAL ANALYSTS JOURNAL / SEPTEMBER-OCTOBER 1974

Segment Reporting Necessary for Investors

The need for segment data for better investor decisions was put before the Financial Accounting Standards Board both in an eight-page FAF response to the Board's Discussion Memorandum on "Financial Reporting for Segments of a Business Enterprise" and in testimony before a public hearing held August 1–2.

The following points were made in the paper submitted on behalf of the FAF's Financial Accounting Policy Committee:

1. The purpose of segment reporting is to enable investors to make better predictions of earning power.
2. Because each segment of a business enterprise is likely to have a different market, profit margin, rate of growth and return on investment, each must be studied separately to develop a projection of earnings for the business as a whole.
3. There should be a balance between homogeneity of segments and the total number of segments reported by one company. (The present SEC requirement of a minimum of 10% of sales or income subject to maintaining reasonable continuity from year to year and to reporting loss operations was deemed satisfactory for larger companies with 15% for smaller ones.)
4. Segment information should be made part of company financial statements and be subject to accounting standards and audit. (A greater degree of approximation and arbitrary allocation is thought acceptable to keep auditing expense at a reasonable level as long as there is adherence to standards for defining segments and general concepts for determining earnings and investment.)
5. Continuity and comparability are important criteria for segment reporting.
6. Criteria for determining segments should be based on economic factors. In some cases geography or processing stages are also important.
7. Sales and some measure of income are minimum requirements for financial reporting of segment operating results.
8. The FASB should establish minimum standards for balance sheet data, consisting of net investment, net current assets, and net fixed investment.
9. Segment information should be required of all companies with securities traded in the public markets.

William C. Norby, C.F.A., wrote the paper submitted to the FASB on behalf of the Financial Accounting Policy Committee (FAPC). He is senior vice president of Duff, Anderson & Clark, Inc., and the 1974–75 chairman of the FAPC. Dr. Frances Stone, C.F.A. specialist at Merrill Lynch, Pierce, Fenner & Smith, Inc., and FAPC chairman for three years, also submitted a paper and appeared with Mr. Norby at the August hearing. Copies of both papers are available from FAF.

"Financial analysts have long sought information on the segments of diversified businesses in making business decisions," the FAF paper stated. "The growing complexity and diversity of many (in fact, most) large corporations makes such information essential to an understanding of the response of the company to multifaceted economic and financial forces affecting it. While consolidated financial statements of complex enterprises are necessary for measurement of total performance, they are of limited value for predicting future cash flows of such businesses, which is the primary use of financial statements by the investor."

FINANCIAL ANALYSTS JOURNAL / NOVEMBER-DECEMBER 1974

FAF Accounting Papers Sent to SEC and FASB

The Financial Accounting Policy Committee of the FAF prepared papers within the past two months for both the Financial Accounting Standards Board and the SEC.

1. **To the SEC** it addressed an August 30 response to a release on capitalization of interest by companies other than public utilities.

The FAF paper gave full support to a proposed moratorium on the accounting procedure for capitalizing interest costs on construction by companies other than public utilities, if they had not adopted such a policy by June 21, 1974. The paper also opposed the extension of the policy to new types of assets by companies that had already adopted the procedure.

Since the FAF committee opposed the accounting procedure in principle, it asked that the FASB debate the procedure and decide upon its merits. In arguing for the moratorium, the FAF paper pointed out that selective adoption by some companies would create vested interests in the procedure which would be difficult to dislodge.

"There is a Gresham's Law in accounting whereunder bad accounting tends to drive out good accounting in pursuit of higher earnings per share," the paper stated. "This is one of those cases."

2. **To the FASB** the FAF committee addressed a lengthy paper in response to a discussion memorandum on the Conceptual Framework for Accounting and Reporting.

The FAPC recommended that the FASB broadly adopt the Report of the AICPA Study Group on the Objectives of Financial Statements as the conceptual framework for the accounting and reporting standards it promulgates in the future.

To a question in the FASB memorandum about deferring consideration of any objectives and qualitative characteristics in the AICPA report, the FAF paper recommended that two issues be deferred or dropped: financial forecasts and social accounting as an objective.

A possible addition to the qualitative characteristics, the FAF paper suggested, would be conservatism.

"The characteristic of freedom from bias is an aspect of conservatism but does not fully express our viewpoint," the FAF paper explained. "Management has a natural optimism about the expected outcome of projects and can argue the case for deferral of expense in order to match expenses with revenues. The conservative approach understands the inherent uncertainty of future outcomes and therefore recognizes expense today instead of tomorrow. Conservatism thus acts as a counter balance to management optimism, thereby reducing unpleasant surprises for investors."

In suggesting the elimination or deferment of two of the objectives, the FAF paper noted that the two are not "unworthy goals" but lie outside the proper field of accounting.

3. **Also to the FASB,** the FAF committee sent comments strongly endorsing a proposed statement on "Accounting and Reporting by Development Stage Companies, Subsidiaries, Divisions and Other Components."

Copies of the three papers are available from the FAF office.

FINANCIAL ANALYSTS JOURNAL / JANUARY-FEBRUARY 1975

FASB Agenda: Leasing, Interim Reporting, Contingencies, and Debt Reclassification

The Federation's Financial Accounting Policy Committee sent views in mid-November to the Financial Accounting Standards Board on its discussion memorandum on Accounting for Leasing. In mid-December the Federation committee sent papers endorsing proposed FASB financial accounting standards on Accounting Changes in Interim Financial Statements, Accounting for Contingencies, and the Classification of Short-Term Obligations Expected to Be Refinanced.

Leasing. The FAF committee took the view that "rapidly increasing debt and financial leverage of many companies requires more comprehensive disclosure on leases to users of financial statements. We believe disclosure of lease obligations in the footnotes to the financial statements . . . is not sufficient. Financing lease obligations should also be capitalized on the balance sheet to insure full and comparative information regarding the financial leverage of companies and hence the risks to both creditors and shareholders."

The FAF paper also indicated that "capitalization could mean conversion of a lease obligation to a debt on the balance sheet while in other cases it could simply mean some multiple or discounting of future rentals. Asset terminology could change correspondingly. . . ."

FAF Responds to Four FASB Exposure Drafts

The Financial Accounting Policy Committee of the Federation, which is chaired by William C. Norby, C.F.A., Chicago, sent comments to the FASB in November and December relating to four exposure drafts.

> *Accounting for Leasing*. The Committee applauded the "basic decision" in the Exposure Draft of the Proposed Statement of Financial Accounting Standards for Accounting for Leases to require capitalization of leases which are classified as capital leases. The committee believes this to be "a real step forward in accounting presentations and in providing investors with more information on a comparable basis." The committee commented upon two additional provisions in the draft, terming the proposed prospective application of the new accounting standard a "very weak provision and a disservice to investors." The committee urged that the FASB make the "hard decision to require retroactive as well as prospective application of the standard" on the ground that it will provide better information for investors. The FAF committee also suggested that the distinction between capital and operating leases be clear enough so that only true capital leases are shown in the balance sheet with adequate information about operating leases included in the footnotes.

> *Accounting for Contingencies—Transition Method*. The exposure draft of a proposed amendment to the FASB Statement No. 5 (Accounting for Contingencies) provides for retroactive restatement of a company's financial statements for as many consecutive prior years as is practicable. The FAF committee supported the FASB exposure draft, urging that restatement be required in all financial statements subject to the Statement, and that exceptions listed in it be deleted. (One dissent favoring the existing standards' cumulative change method as more appropriate for transition was noted.) The FAF committee response noted that "...restatement of prior periods is the most appropriate method of applying changes in accounting principles. By providing two comparable reporting periods, this method better meets analysts' needs."

> *Restructuring of Debt in a Troubled Loan Situation*. The exposure draft of a proposed statement of Financial Accounting Standards applies to situations in which the borrower has such financial difficulties that the lender is economically compelled to accept a restructured loan arrangement with terms significantly different from those acceptable in a new loan situation. The proposal would require that restructuring of a troubled loan be accounted for by measuring the gain or loss based on the effective interest rate of the old debt except that issuance of stock or other equity securities for debt would be considered a capital transaction on which no gain or loss is recognized. A gain or loss would be recognized by the debtor when principal or accrued interest has been forgiven or when the future rate is modified. If adopted, the standard would be applied to debt restructuring transactions that occurred in fiscal years ending on or after January 1, 1975.

The response of the FAF Financial Accounting Policy Committee recognized the increasing number of debt modifications and exchanges taking place in the corporate sector generally but with a concentration in the real estate industry. The response questioned whether the proposed accounting standard provides useful information to investors for measuring income or liabilities. Doubt was expressed that debt restructuring is a transaction requiring accounting recognition, although full disclosure of details of any restructuring is needed in the notes to financial statements. The committee response also noted that if the standard is adopted "it is especially important that another standard be adopted to cover the creditor's side of a restructured debt transaction." The paper urged that the FASB consider the matter promptly. The paper also urged that the definition of a troubled loan situation include possible "gray" areas.

> *Accounting for Certain Marketable Securities*. The exposure draft of a proposed statement of a Financial Accounting Standard would require a lower-of-cost-or-market carrying basis for certain marketable securities and that certain unrealized gains and losses be brought into income. The proposed statement would not apply to organizations or companies with specialized accounting practices, or to employee benefit plans, which are the subject of special FASB consideration. If adopted, the proposed statement would be effective for fiscal periods ending on or after December 31, 1975, or ending earlier in December, 1975 for enterprises with fiscal years of 52 or 53 weeks, with restatement for earlier periods.

The Financial Accounting Policy paper endorsed the proposed statement as a first step toward a more comprehensive standard on marketable securities. "Although limited in scope, it should provide more realistic information to users," the response noted. The committee paper supported reasoning emphasizing the "realism of market values" and endorsed the collective asset concept of the portfolio. The paper urged that the FASB immediately consider accounting for marketable securities on a comprehensive basis, since "it would not be desirable to introduce partial modifications of present accounting standards without proceeding the whole distance."

The committee paper also viewed the following as important in any comprehensive standard: abandonment of the historical cost principle; inclusion of bonds as well as equities; and clear separation of realized and unrealized gains and losses for marketable securities from operations gains and losses. The committee urged that the concepts also be considered insofar as possible in the proposed limited standard of the exposure draft. Sub-committees chaired by Gerald I. White, C.F.A. (Contingencies-Transition method), Clyde E. Bartter, C.F.A., C.P.A. (Troubled Debt) and Lawrence Ross and Rosemarie Tevelow, C.F.A., C.P.A., (Certain Marketable Securities) prepared the responses.

Four Accounting Responses Filed

The Financial Accounting Policy Committee in January and February responded to one release of the Securities and Exchange Commission and to three major proposed positions of the Financial Accounting Standards Board.

SEC Replacement Cost Disclosure Supported

In its response to the SEC's Proposed Amendments to Regulation S-X regarding replacement cost disclosure, the FAF committee strongly endorsed the Commission's proposed disclosure requirements for replacement cost of inventory and productive capacity. The FAF paper recognized the "inherent imprecision" of the data, but argued that it would nonetheless be useful to analysts and investors in assessing the effects of inflation upon reported earnings.

Among specific comments, the committee:

> **Urged** that the current value of land be included in the proposed disclosure requirements and that the valuation of mineral reserves include some disaggregation, as by geography or industry.

> **Disagreed** with the Commission's proposed requirement for straight line depreciation and urged that the replacement cost depreciation figure be based on the same depreciation methods and asset lives used in historical cost statements.

> **Found it unnecessary** to require formal inclusion of the replacement cost disclosures within the audited portion of the financial statements, or to limit the application of the proposed disclosure requirements because of the size of a company.

Gerald I. White, C.F.A. of New York, chaired the subcommittee preparing the response.

FASB Segments Draft Called "Major Step"

The FAPC found the Exposure Draft of a proposed FASB standard for financial reporting for segments of a business enterprise "a major step forward" that would provide investors with adequate, useful, consistent, and comparable information. Among provisions of the proposed standard that the committee found especially important were: incorporation of segment data in the set of financial statements subject to audit; provision for data on foreign operations, major customers, and export sales as well as on industry segments; provision for asset data as well as an income statement; standardization of accounting presentation of segment data; and broad applicability to all companies.

To strengthen or clarify the proposed standard, the committee urged that segment reporting be required to the net income level, including foreign operations by major countries or areas, at least where there are significant differences in capital costs or effective income tax rates between segments or geographic areas.

The basic paper was prepared by a subcommittee chaired by Martin W. Davenport, C.F.A. and Sam Sparhawk, III, C.F.A. of Philadelphia.

Judgment Critical Factor in Determining Materiality

The FAF responded to the FASB's Discussion Memorandum analyzing the issues relating to Criteria for Determining Materiality in a fourteen-page statement, excluding appendix.

In a paragraph summarizing its viewpoint, the FAPC paper read: "...The orientation for determining materiality should be to provide information to existing and potential stockholders and creditors for making economic decisions. Financial information should be disclosed for materiality reasons if it can be reasonably expected to influence the judgment of a well-informed investor. In assessing materiality, both preparers and auditors should ask themselves the following question: Are misleading interpretations likely to be drawn from the financial statements if a particular item is not disclosed?"

Although some quantitative guides to materiality can be useful, the paper went on, "judgment will always be critical. Agreement on the objectives of financial statements and knowledge of the investor's decision model therefore are essential to improved determination of materiality."

In commenting upon user decision models, the paper holds that if the needs of professional users of financial statements are met, the needs of other users will be met.

Factors other than those involving the magnitude or financial effects of a transaction should be considered in determining materiality, the paper argued, citing five such matters: the economic environment; accounting changes; unusual and infrequent items; sensitive situations; and the cumulative effect of financial matters.

Primary emphasis in determining materiality should be placed upon the concept of earnings trend and the growth rate and changes in the growth rate, the paper indicated.

In conclusion the paper dealt with the matter of practicality. Examples of excellent disclosure were cited to indicate that an increased emphasis on earnings trends can be readily accomplished. The incremental cost involved was not believed to be great, since "the internal reporting systems and accounting records of most companies already have such data on hand."

William J. Goldsborough, C.F.A., C.P.A., of Chicago was subcommittee chairman.

Future Is Focus of Pension Plan Reporting

A fifteen-page statement was sent to the FASB in response to its Discussion Memorandum on Accounting and Reporting for Employee Benefit Plans.

The paper argued that the pension plan, as opposed to the administering fund, be the accounting and reporting entity and that liability of the plan for future benefit payments should assume a going concern basis and be based on service and compensation accrued to date by eligible employees, both vested and non-vested. To assist the user in the analysis of the liability of the sponsor for contributions and to provide comparability between companies and possible differences in actuarial approaches, the paper held that separate schedules of several factors are needed.

It suggested three possible schedules: one to show the rate of amortization of the liability; another to show the potential growth of fund assets at alternative possible rates of return; and a third to show the overall rate required from both sources to discharge the liability and to show the sensitivity to changes in the rate or to changes in the plan benefits.

"This approach to reporting could reduce dependence on alternative actuarial assumptions," the paper stated. "It may appear to provide uncertain answers, but that is the nature of pension plans. All of the variables are dependent on the future, and the future is uncertain."

The statement was prepared by a subcommittee of three: Edward B. Dillmann, C.F.A., Chicago, Robert G. Ellis, C.F.A., Chicago, and Theodore R. Lilley, C.F.A., New York.

William C. Norby, C.F.A., Chicago, chairs the Financial Accounting Policy Committee. Copies of FAPC papers are available from the FAF office upon request.

APPENDIX H—FINANCIAL ACCOUNTING STANDARDS BOARD

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

5 May 1976

Mr. Marshall S. Armstrong
Chairman of the Board
Financial Accounting Standards Board
High Ridge Park
Stamford, Connecticut 06905

Dear Mr. Armstrong:

Exhibit Reference

The information which you and your staff have provided to this subcommittee on the activities of the Financial Accounting Standards Board has been very useful. However, some questions have arisen in conjunction with our analysis of FASB activities.

In order that we may better understand the functioning of the Board, please provide this subcommittee with the following information:

1) the salaries earned by the chairman and each member of the FASB, along with the amounts and types of fringe benefits received; — 1 and 1.01

2) a list of the contributions received by the Financial Accounting Foundation, including the identities and business affiliations of the donors; — 2, 2.01, 2.02, and 2.03

3) a list of the memberships of each trustee of the FAF, FASB member, and FASB Advisory Council member in any of the five sponsoring organizations listed on page 2 of the 1975 FASB annual report; — 3

4) a detailed explanation of the restrictions on outside financial interests mandated in Section 4 of the By-Laws of the Financial Accounting Foundation; — 4, 4.01, and 4.02

	Exhibit Reference
5) an explanation of any restrictions on financial interests or positions held by trustees of the FAF, corporate electors of the FAF, or members of the FASB Advisory Council;	5
6) a listing of the professional staff of the FASB indicating the position and previous employment of each individual;	6
7) a listing of consultants to the FASB indicating the assigned task and business affiliation of each; and	7, 7.01, and 7.02
8) copies of any testimony or presentations by the FASB before Congress, state legislatures, Federal or state regulatory agencies.	8 and 8.01 through 8.04
On page 8 and 9 of the 1975 FASB annual report, the section titled "Liaison With Other Organizations" mentions relationships between the FASB and various Federal agencies and departments as well as the Congress. Please describe in more detail the FASB's communications with Congress, the SEC, the CASB, and any other Federal agency or department.	8 and 8.05 through 8.15

The section on liaisons also contains the following paragraph:

"In an effort to develop a broader sense of the views of our "constituency", we are undertaking a series of meetings with prominent public accountants, businessmen, and members of the academic community. It is anticipated that these meetings, which are not addressed to specific technical issues, will be highly productive in providing us with insight into the thinking of these knowledgeable individuals, and with a clearer understanding of how we may even better fulfill our responsibilities to the public-at-large."

Please describe in detail each such meeting held or planned including the purpose and participants at each meeting. Are any meetings planned with groups representing	9, 9.01, and 9.02

	Exhibit Reference
interests other than the aforementioned prominent public accountants, businessmen, and members of the academic community?	9 (page 3, penultimate paragraph)

As we are trying to expedite our present accounting inquiry, I ask your cooperation in providing this information by 28 May. Any questions regarding this request may be directed to subcommittee counsel Jack Chesson at (202) 224-1474.

Very truly yours,

Lee Metcalf

Financial Accounting Standards Board
HIGH RIDGE PARK, STAMFORD, CONNECTICUT 06905 | 203·329·8401

FASB

MARSHALL S. ARMSTRONG, Chairman of the Board

May 27, 1976

The Honorable Lee Metcalf
Chairman
Subcommittee on Reports,
 Accounting, and Management
Committee on Government Operations
United States Senate
1121 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Metcalf:

Enclosed, in triplicate, is our response to your letter of May 5, 1976 requesting certain information about the functioning of the Financial Accounting Standards Board. As indicated in the Table of Contents and Cross-Reference Table, the exhibits are keyed by number to the inquiries set forth in your letter.

I trust the enclosed submission provides the information you requested. If you desire additional information, please contact me -- or the Subcommittee staff may wish to contact Michael A. Pinto, the FASB's director of administration, or Robert Van Riper, administrator for public information.

Sincerely,

Marshall S. Armstrong

Marshall S. Armstrong

MSA:kjp
Enclosures

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Abbreviations Used

AAA	--	American Accounting Association
AICPA	--	American Institute of Certified Public Accountants
APB	--	Accounting Principles Board
FAF	--	Financial Analysts Federation
FASB	--	Financial Accounting Standards Board
FASAC	--	Financial Accounting Standards Advisory Council
FEI	--	Financial Executives Institute
NAA	--	National Association of Accountants

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Description of the Organization *

The Financial Accounting Standards Board is one of three related bodies, each having separate functions, which comprise a tripartite structure for establishing and improving standards of financial accounting and reporting. Related to the Standards Board are the Financial Accounting Foundation and the Financial Accounting Standards Advisory Council.

The Financial Accounting Foundation, the organization which formed the Standards Board and the Advisory Council, was incorporated June 30, 1972 as a body separate from all existing professional organizations "to operate exclusively for charitable, educational, scientific, and literary purposes" within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1954.

The following is a brief description of the three bodies.

A. The Financial Accounting Foundation

The Financial Accounting Foundation is governed by a Board of Trustees composed of nine members** whose principal duties are:

1. To appoint the members of the Financial Accounting Standards Board.
2. To appoint the members of the Financial Accounting Standards Advisory Council.
3. To arrange for the financing of the organization.
4. To prepare and administer the budget of the Financial Accounting Foundation.

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*See Appendix C for Certificate of Incorporation and By-Laws of the Foundation.

**See Note 1 to Exhibit 3.

5. To approve the annual budget of the Financial Accounting Standards Board and the Financial Accounting Standards Advisory Council, as prepared and presented by the Chairman of the Standards Board.

6. To review periodically the By-Laws of the Financial Accounting Foundation, and the basic structure for establishing and improving standards of financial accounting and reporting.

The Foundation's By-Laws expressly prohibit the Trustees from participating in resolution of technical issues by the Standards Board.*

B. The Financial Accounting Standards Board

The seven members of the Standards Board are appointed by the Board of Trustees of the Financial Accounting Foundation for five-year terms. Of the seven members, all of whom are fully remunerated and serve full-time, four are certified public accountants drawn from public practice or, in the judgment of the Board of Trustees, principally experienced as public practitioners. The remaining three members, who need not but may be certified public accountants, include one accounting educator, one corporate financial executive, and one person from the federal government.

The Certificate of Incorporation of the Financial Accounting Foundation delegates to the Financial Accounting Standards Board all authority, functions and powers of the Foundation and its Board of Trustees in respect of standards of financial accounting and reporting, including the conduct of all related activities. As a result, the Financial Accounting Standards Board has responsibility, among other things, for issuing Statements of Financial Accounting

*Section 1, Article I-A. (See also Exhibit 5)

Standards and Interpretations of those Statements, Interpretations of Accounting Research Bulletins of the Committee on Accounting Procedure of the American Institute of Certified Public Accountants, and Interpretations of Opinions of the Accounting Principles Board of the AICPA.

Authoritative pronouncements may be issued only on the affirmative vote of five of the seven Board members. The Board maintains an extensive record available for public review, and at all stages solicits the views of interested persons and groups from both the private and public sectors.

C. The Financial Accounting Standards Advisory Council

The Financial Accounting Standards Advisory Council consists of 32 persons (see Appendix E) who, in the judgment of the Board of Trustees of the Financial Accounting Foundation, are knowledgeable about the problems and impact of financial reporting or who possess an expertise of value to the Financial Accounting Standards Board. Members of the Advisory Council are broadly representative of varied professional and occupational backgrounds with no profession or occupation predominating. Members are appointed for one-year terms by the Board of Trustees of the Financial Accounting Foundation.

The Advisory Council is one vehicle for contact with and communication between the Standards Board and interested persons and organizations. Members of the Advisory Council are expected to work closely with the Financial Accounting Standards Board in an advisory capacity. Thus, upon the request of the Chairman of the Standards Board (who is also Chairman of the Advisory Council), members of the Advisory Council consult with the Chairman or the

Standards Board concerning the Standards Board's agenda of projects and the assigning of priorities thereto, matters likely to require the attention of the Standards Board, the selection and organization of task forces to work on specific projects, and such other matters as may be requested. Upon request of the Chairman, members also provide written comments in respect of Interpretations proposed to be issued by the Standards Board. The Chairman and the Standards Board consider fully and carefully all advice and comments offered by members of the Advisory Council, but are not precluded from seeking advice and comments from, and consulting with, other persons and organizations.

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Exhibit 1

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Annual Compensation of Members of the
Financial Accounting Standards Board
as of May 15, 1976
(Notes 1 and 2)

Name	Position	Total Annual Compensation
Marshall S. Armstrong	Chairman	$150,000
Robert T. Sprouse	Vice Chairman	115,000
Oscar S. Gellein	Member	115,000
Donald J. Kirk	Member	115,000
Arthur L. Litke	Member	115,000
Robert E. Mays	Member	115,000
Walter P. Schuetze	Member	115,000

Note 1: Members of the Financial Accounting Standards Board serve full time and are required to sever all connections with the firms or institutions they served prior to joining the Board. (See Exhibit 4 and Appendix C.)

Note 2: Compensation is expressed before giving effect to salary reduction agreements executed by each member of the FASB under the provisions of Sections 403(b) and 415 of the Internal Revenue Code. Under such salary reduction agreements, the amount of the salary reduction is contributed on a Federal income tax deferred basis by the FASB to Teachers Insurance and Annuity Association and/or College Retirement Equities Fund for the purchase of retirement income annuities.

Exhibit 1.01
(page 1 of 3)

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Fringe Benefits Provided for Members
of the Financial Accounting Standards Board

Retirement Income Benefit

The Financial Accounting Foundation contributes an amount equal to 10% of each Board Member's gross annual salary (see Note 2 to Exhibit 1) to Teachers Insurance and Annuity Association and College Retirement Equities Fund for the purchase of annuities. Such contributions are made on a Federal income tax deferred basis under Sections 403(b) and 415 of the Internal Revenue Code and are in addition to those contributions described in Note 2 to Exhibit 1. The value of all benefits purchased by these contributions vests immediately with each Board Member.

The Financial Accounting Foundation has guaranteed to the present FASB Chairman, Marshall S. Armstrong, that any deficiency between the amount of annual retirement income benefit payable to him or his spouse, on a last survivor basis, derived from the Foundation contribution of 10% of his salary and the fixed annual amount of $15,000 will be funded by the Foundation.

Group Long-Term Disability

Each Board Member is covered under a long-term disability program. In the event of a disability longer than 90 days resulting from accident or illness, a Board Member would receive, up to his 65th birthday, a monthly indemnity benefit equal to the lesser of 60% of his salary or $2,000, reduced by amounts received under the Social Security Act and/or Workmen's Compensation or similar laws.

Exhibit 1.01
(page 2 of 3)

Group Long-Term Disability (concluded)

Under the salary continuation policy of the FASB, a Board Member would receive 100% of his salary for the first 90 days of disability.

Group Life Insurance

Each Board Member receives group life insurance in an amount equal to his annual salary (see Exhibit 1), to a maximum of $150,000.

Major Medical Benefits

This plan provides for payment of specified amounts for specified surgical procedures, to a maximum of $3,600 per family member per procedure; and for payment (80% for the first $2,500, 100% thereafter) of the actual cost (after a small deductible amount) of generally all major medical costs, to a lifetime maximum of $1,000,000 for each family member.

Group Hospitalization

All Board Members are eligible for coverage under a standard Connecticut Blue Cross group, semi-private hospitalization plan. Under this program, payment is made for up to 485 days of basic and additional inpatient general care in member hospitals in Connecticut, and 120 days of such care in an approved hospital outside of Connecticut. Certain special and outpatient benefits are also included in the plan.

Group Travel Accident Insurance

Under the terms of the group travel accident insurance, each Board Member is insured to the extent of $200,000 (loss of life or two limbs -- $100,000 for the loss of one limb), resulting from virtually any type of accident. This coverage is in effect 24 hours per day.

Exhibit 1.01
(page 3 of 3)

Social Security

The Financial Accounting Foundation has waived its exemption from the requirement to participate in the retirement, disability and medical benefits of the Federal Insurance Contributions Act. Correspondingly, all Board Members were given the opportunity to enroll and make contributions in accordance with the provisions of this Act. All but one member of the Board has elected to make such contributions.

*   *   *   *   *

Coverage similar to that outlined above is provided for staff of the Financial Accounting Standards Board.

Exhibit 2

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Summary of Contributions Received by
Financial Accounting Foundation for the
Years Ended December 31, 1975 and 1974

	1975		1974	
General Sources	Number of Contributors	Amount	Number of Contributors	Amount
Public Accounting Profession (see Exhibit 2.01)	4,619*	$2,059,076	4,776*	$1,990,083
Industry and Commerce (see Exhibit 2.02)	1,397	1,928,349	1,224	1,899,169
All Other (see Exhibit 2.03)	14	141,776	180	95,042
		$4,129,201		$3,984,294

*Represents primarily the membership of the Accounting Research Association of the AICPA.

Exhibit 2.01
(page 1 of 4)

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Contributions Received from the Public Accounting Profession
for the Years Ended December 31, 1975 and 1974

NAME	AMOUNT 1975	AMOUNT 1974
Accounting Research Association, Inc. (Note 1)	$1,750,000	$1,689,551
American Institute of Certified Public Accountants	207,726	200,000
Alexander Grant & Company	27,500	27,500
J.K. Lasser & Company	40,200	40,200
Laventhol and Horwath	15,750	15,750
Main Lafrentz & Co.	17,000	17,000
Other	900	82
	$2,059,076	$1,990,083

Note 1: Accounting Research Association, Inc. (of the AICPA) contributions to the Financial Accounting Foundation are supported out of dues paid to the Accounting Research Association (ARA) by members of the accounting profession. Listed below are those accounting firms whose membership dues to the ARA are $1,000 or more in each year.* Details regarding contributions or dues of less than $1,000 are not included since, in the aggregate, they are not significant.

NAME OF ARA MEMBER	ARA DUES AMOUNT 1975	ARA DUES AMOUNT 1974
Alford, Meroney & Company	$ 3,750	$ 3,750
Altschuler, Melvoin and Glasser	1,600	1,600
Anchin, Block & Anchin	1,600	1,600
Arthur Andersen & Co.	200,000	200,000

*From information provided by the ARA.

Exhibit 2.01
(page 2 of 4)

NAME OF ARA MEMBER (continued)	ARA DUES AMOUNT 1975	1974
Anderson, Helgeson, Lieser and Thorsen	$ -	$ 1,000
Andrews, Burket & Co.	1,000	-
Baird, Kurtz & Dobson	1,600	1,600
Broeker, Hendrickson & Co.	3,750	3,750
Cherry, Bekaert & Holland	6,250	3,750
Chilton, Stump & Daverio	1,000	1,000
Christiansen and Company	1,000	1,000
Clifton, Gunderson & Co.	1,600	1,600
Coopers & Lybrand	200,000	200,000
Eide, Helmeke, Boelz & Pasch	1,000	-
Eisner & Lubin	3,750	3,750
Ernst & Ernst	200,000	200,000
Robert M. Finn & Company	2,000	-
John F. Forbes & Company	3,750	3,750
Elmer Fox, Westheimer & Company	21,000	21,000
Alexander Grant & Company*	52,500	52,500
M.B. Hariton and Company	1,000	1,000
Harris, Kerr, Forster & Company	21,000	21,000
Haskins & Sells	200,000	200,000
Hood and Strong	1,000	-
Hurdman and Cranstoun	12,000	12,000
Icerman, Johnson & Hoffman	-	1,000
Glenn Ingram & Co.	1,600	1,000
Kafoury, Armstrong, Turner & Co., P.C.	1,000	1,000

*These firms have elected to contribute to the Foundation amounts in excess of the ARA membership dues (see page 1 of this Exhibit).

Exhibit 2.01
(page 3 of 4)

NAME OF ARA MEMBER (continued)	ARA DUES AMOUNT 1975	1974
J.K. Lasser & Company*/**	$ 9,800	$ 9,800
Laventhol and Horwath**	36,750	36,750
S.D. Leidesdorf & Co.	21,000	21,000
Kenneth Leventhal & Co.	3,750	6,250
Main Lafrentz & Co.*	33,000	33,000
May, Zima & Co.	1,000	1,000
McGladrey, Hansen, Dunn & Company	12,000	12,000
McKnight, Frampton, Buskirk and Co.	1,000	-
Meaden & Moore	1,000	1,000
Moss, Adams & Co.	1,600	1,600
Murphy, Lanier & Quinn	1,000	1,000
Geo. S. Olive & Co.	3,750	3,750
Oppenheim, Appel, Dixon & Co.	3,750	6,250
Peat, Marwick, Mitchell & Co.	200,000	200,000
Price Waterhouse & Co.	200,000	200,000
A.M. Pullen & Company	6,250	6,250
Schultz, Krahe, Martin & Long	1,000	1,000
Seidman & Seidman	21,000	21,000
Stockton, Bates & Co.	1,000	1,000
Touche Ross & Company	200,000	200,000

*For explanation see * on page 2 of this Exhibit.

**These firms have chosen to pay a portion of their membership dues directly to the Foundation. The amount reflected above does not include such direct payments (see page 1 of this Exhibit).

Exhibit 2.01
(page 4 of 4)

NAME OF ARA MEMBER (concluded)	ARA DUES AMOUNT 1975	1974
Lester Witte & Company	3,750	3,750
Yergen & Meyer	1,000	1,000
Arthur Young & Company	200,000	200,000
Total of ARA dues amounts of $1,000 or more	$1,908,150	$1,906,050
Number of ARA members whose dues are $1,000 or more	49	46
Number of ARA members whose dues are less than $1,000	4,566	4,727
Total	4,615	4,773

Exhibit 2.02
(page 1 of 25)

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

CONTRIBUTIONS RECEIVED FROM INDUSTRY AND COMMERCE
FOR THE YEARS ENDED DECEMBER 31, 1975 AND 1974

NAME	AMOUNT	
Individual contributions of $1,000 or more (Note 1):	1975	1974
Abbott Laboratories	$ 3,000	$ 3,000
ACF Industries	2,000	2,000
Acme-Cleveland Corp.	2,000	2,000
Aetna Life & Casualty Co.	2,500	2,500
Agway Inc.	2,500	2,500
Air Products & Chemicals Corp.	2,500	2,000
Airco, Inc.	1,000	500
Alabama Power Company	1,000	1,000
Alan Wood Steel Company	1,000	1,000
Albany International Corp.	1,000	1,000
Allegheny Ludlum Industries	2,500	2,500
The Allen Group	100	2,000
Allen-Bradley Co.	2,000	2,000
Allendale Mutual Insurance Co.	1,000	1,000
Allied Chemical Foundation	4,000	4,000
Allied Mills, Inc.	1,000	2,000
Allis-Chalmers Corp.	2,500	2,500
Allstate Insurance Co.	5,000	5,000
Aluminum Company of America	4,500	4,000
AMBAC Industries Inc.	1,000	1,000

Note 1: Details regarding contributions of less than $1,000 are not included since, in the aggregate, they are not significant.

Exhibit 2.02
(page 2 of 25)

NAME	AMOUNT 1975	1974
Amcord, Inc.	$ 1,000	$ 1,000
American Natural Gas Service Company	3,500	3,500
Amerada Hess Corporation	-	1,000
American Airlines, Inc.	1,000	1,000
American Brands, Inc.	1,000	1,000
American Broadcasting Co., Inc.	-	1,000
American Can Co.	1,500	1,500
American Cyanamid Co.	2,000	2,000
American Electric Power Co.	4,000	4,000
American Express Co.	4,000	4,000
American Fletcher National Bank	1,500	1,500
American General Insurance Co.	2,500	2,500
American Hospital Supply Corporation	3,500	3,500
American International Group	2,000	2,000
American Medical International, Inc.	1,000	1,000
American Metal Climax, Inc.	1,000	1,000
American Motors Corp.	3,500	3,500
American Standard Inc.	3,500	3,500
American Thread Co.	1,000	1,000
Ametec Inc.	1,000	1,000
AMF Incorporated	-	1,000
Amfac, Inc.	3,000	3,000
AMP Incorporated	2,000	-
Amstar Corp.	1,000	1,000
The Anaconda Company	2,500	-
Anderson Clayton and Co.	1,500	1,500

Exhibit 2.02
(page 3 of 25)

NAME	AMOUNT 1975	1974
The Andersons (Wholesalers)	$ 2,000	$ -
Anheuser-Busch, Inc.	4,000	-
ARA Services, Inc.	1,000	1,000
Archer-Daniels-Midland Co.	2,500	2,500
Arkwright-Boston Insurance Co.	1,000	1,000
Armco Steel Corp.	4,000	4,000
Armstrong Cork Co.	3,500	3,500
Asarco, Inc.	3,500	3,500
Ashland Oil, Inc.	6,000	4,000
Associated Corporation of North America	-	2,500
AT&T Co.	40,000	40,000
Athlone Industries, Inc.	2,000	2,000
Atlantic Richfield Co.	10,000	10,000
Automatic Data Processing, Inc.	1,000	-
Avery Products Corp.	1,000	1,000
Avon Products, Inc.	4,000	4,000
The Babcock & Wilcox Co.	3,500	3,500
Baker International Corporation	-	1,000
D. H. Baldwin Co.	1,000	500
Bandag, Inc.	1,000	-
The Bank of California, N.A.	750	1,500
Bank of Virginia Co.	-	1,500
Bankers Trust New York Corp.	3,000	3,000
Baxter Laboratories, Inc.	1,100	1,000
Beatrice Foods Co.	3,000	-
Bell & Howell Co.	2,000	2,000
Bemis Company, Inc.	2,500	2,500
The Bendix Corporation	1,000	1,000

Exhibit 2.02
(page 4 of 25)

NAME	AMOUNT 1975	1974
Bethlehem Steel Corp.	$ 5,000	$ 5,000
The Bibb Co.	500	1,000
Bliss & Laughlin Industries	1,000	-
Blue Bell Inc.	1,000	1,000
The Boeing Company	4,000	4,000
Boise Cascade Corp.	5,000	5,000
Booth Newspapers, Inc.	1,000	1,000
Borden, Inc.	2,000	2,000
C. Brewer & Co., Limited	1,000	1,000
Briggs & Stratton Corp.	2,500	2,500
Bristol-Myers Company	3,000	3,500
Brooklyn Union Gas Co.	1,000	1,000
Brown Co.	-	1,000
Brown Group, Inc.	3,000	3,000
Brunswick Corporation	-	3,000
Buckeye Pipe Line Co.	1,000	1,000
The Budd Company	3,000	3,000
Bunker Ramo Corp.	-	2,000
Burlington Industries Corp.	4,000	4,000
Burlington Northern Corp.	2,000	3,000
Burroughs Corporation	3,000	3,000
Butler Manufacturing Co.	500	1,000
C.I.T. Financial Corp.	5,000	5,000
Cabot Corporation	-	1,000
Cameron Iron Works, Inc.	2,000	2,000

Exhibit 2.02
(page 5 of 25)

NAME	AMOUNT 1975	1974
Campbell Soup Company	$ 2,500	$ 3,000
The Carborundum Co.	2,000	2,000
Carnation Co.	2,500	2,500
Carpenter Technology Corp.	1,000	1,000
Carrier Corporation	3,000	3,000
Carter Hawley Hale Stores, Inc.	2,000	2,000
Carter-Wallace, Inc.	-	2,000
Castle & Cook, Inc.	2,000	2,000
Caterpillar Tractor Co.	25,000	25,000
CBS, Inc.	4,000	4,000
Ceco Corp.	500	1,000
Celanese Corporation	7,000	3,500
Centex Corp.	2,000	2,500
Central Maine Power Co.	2,000	-
Cerro Corp.	2,500	2,500
Certain-Teed Products Corp.	1,000	-
Cessna Aircraft Co.	-	2,000
Champion International Corp.	1,000	1,000
Champion Spark Plug Co.	3,000	3,000
Charter New York Corp.	3,000	3,000
Chase Manhattan Corp.	5,000	-
Chemetron Corporation	2,000	2,000
Chemical New York Corp.	4,000	4,000
Chesebrough-Pond's, Inc.	2,500	2,500
Chicago Milwaukee Corp.	-	2,000
Chicago Pneumatic Tool Co.	1,000	1,000
Chromalloy American Corp.	1,000	-
Chrysler Corporation	10,000	18,000

Exhibit 2.02
(page 6 of 25)

NAME	AMOUNT 1975	1974
Chubb Corp.	$ 2,500	$ -
Cities Service Company	4,000	4,000
City Investing Co.	4,000	4,000
Clark Equipment Co.	1,000	2,500
Clark Oil & Refining Co.	1,000	1,000
Cleveland Trust Co.	500	2,500
The Coca-Cola Co.	5,000	5,000
Colgate-Palmolive Co.	1,000	2,500
Colonial Penn Insurance Co.	2,000	2,000
Colonial Stores Inc.	-	1,000
Colorado Interstate Corp.	2,000	2,000
Colt Industries Inc.	3,000	3,000
The Columbia Gas System, Inc.	4,000	3,500
Combustion Engineering	2,000	2,000
Commerce Clearing House, Inc.	1,000	1,000
Communication Satellite Corporation	1,250	1,250
Connecticut General Insurance Co.	1,250	1,250
Consolidated Foods Corp.	2,500	2,500
Consolidated Freightways, Inc.	2,500	2,500
Consolidated Natural Gas Service Co.	3,500	3,500
Consolidated Papers, Inc.	1,000	1,000
Continental Bank, N.A.	1,000	1,000
Continental Can Co.	1,000	500
Continental Copper & Steel Industries	1,000	-
Continental Insurance Co.	1,500	1,500

Exhibit 2.02
(page 7 of 25)

NAME	AMOUNT 1975	1974
Continental Investment Co.	$ 100	$ 1,000
Continental Oil Co.	9,000	8,000
Continental Telephone Corp.	2,000	2,000
Control Data Corporation	-	2,000
Cook Industries, Inc.	3,000	3,000
Cook United, Inc.	1,000	1,000
Cooper Industries, Inc.	2,000	2,000
Cooper Laboratories, Inc.	100	1,000
CPC International, Inc.	4,000	4,000
Crompton & Knowles Corp.	1,000	1,000
Connelly Foundation	3,000	3,000
Crum & Forster, Inc.	1,000	1,000
Cutler-Hammer, Inc.	2,000	2,000
Dart Industries, Inc.	2,000	-
Dayton Power & Light Co.	1,000	-
Deere & Co.	5,000	4,000
Del Monte Corp.	3,500	3,500
Delmarva Power & Light Co.	1,000	1,000
Delta Air Lines, Inc.	1,000	1,000
Dennison Manufacturing Co.	1,000	1,000
Desoto, Inc.	-	1,500
Detroit Edison Company	3,500	3,500
Di Giorgio Corporation	2,500	2,500
A. B. Dick Company	1,000	1,000
Dillingham Corporation	1,000	1,000

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Exhibit 2.02
(page 8 of 25)

NAME	AMOUNT 1975	AMOUNT 1974
R. R. Donnelley & Sons Co.	$ 2,500	$ 2,500
The Dow Chemical Company	18,000	6,000
Dow Jones & Co., Inc.	2,000	2,000
Dr. Pepper Co.	1,000	1,000
Dresser Foundation	3,500	3,500
E. I. du Pont de Nemours & Co., Inc.	12,000	12,000
Ducommun Inc.	1,250	1,000
Duke Power Co.	3,500	3,500
Dun & Bradstreet Companies, Inc.	2,500	2,500
Eastman Kodak Company	12,000	12,000
Eaton Corporation	3,500	3,500
El Paso Natural Gas Co.	3,000	3,000
Eli Lilly & Company	2,500	2,500
Emerson Electric Co.	-	3,000
Englehard Mineral & Chemicals Corp.	1,000	1,000
Equitable Life Assurance Society of the U. S.	4,000	4,000
ESB Incorporated	-	2,500
Esmark, Inc.	3,000	2,500
Essex International, Inc.	-	2,500
Ethyl Corporation	1,500	1,500
Evans Products Company	-	3,500
Ex-Cell-O Corp.	1,000	1,000
Exxon Corporation	40,000	40,000
Fairchild Industries, Inc.	-	2,000
Federal Paper Board Co., Inc.	1,000	2,000
Federal-Mogul Corp.	1,000	2,000
Federated Department Stores, Inc.	5,000	5,000

Exhibit 2.02
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NAME	AMOUNT 1975	1974
Fibreboard Corp.	$ 1,000	$ -
The Fidelity Bank, N.A.	1,000	1,000
Fieldcrest Mills, Inc.	1,000	-
Firestone Tire & Rubber Co.	6,000	6,000
First Bank System, Inc.	3,000	3,000
First Commerce Corp.	1,000	-
First National Bank of Chicago	-	2,000
First National Stores, Inc.	1,000	1,000
First National Bank of Minneapolis	-	1,000
First National Bank of Oregon	2,000	2,000
First National City Bank	10,000	10,000
First Pennsylvania Corp.	2,500	2,500
First Tennessee National Corporation	1,000	1,000
Fischbach & Moore, Inc.	1,000	-
Fleming Companies, Inc.	1,000	1,000
The Flintkote Co.	1,000	1,000
Florida Power & Light Co.	1,000	1,000
Fluor Corp.	3,500	3,500
FMC Corporation	3,500	3,500
Ford Motor Company	15,000	35,000
Foremost-McKesson, Inc.	1,000	1,000
Foster Grant Co., Inc.	-	1,000
The Foxboro Company	1,000	1,000
Franklin Mint Corp.	-	1,000
Fuqua Industries	1,000	1,000
Frank E. Gannett Newspaper Fdn., Inc.	2,500	2,000
General Cable Corp.	1,000	1,000
General Electric Co.	23,000	23,000

Exhibit 2.02
(page 10 of 25)

NAME	AMOUNT 1975	1974
General Foods Corp.	$ 6,000	$ 5,000
General Mills, Inc.	4,000	4,000
General Motors Corp.	40,000	40,000
General Signal Corp.	2,500	2,500
General Tire & Rubber Co.	3,500	3,500
Getty Oil Company	2,300	2,300
The Gillette Company	4,000	3,500
Girard Bank	1,000	1,000
Goldman, Sachs & Co.	1,500	1,500
The B. F. Goodrich Co.	3,500	3,500
Goodyear Tire & Rubber Co.	9,000	9,000
GPU Service Corp.	2,500	2,500
W. R. Grace & Co.	6,000	4,000
W. W. Grainger, Inc.	2,000	-
Great Atlantic & Pacific Tea Co., Inc.	1,000	5,000
Great Northern Nekoosa Corp.	1,000	-
Great Western Financial Corp.	1,000	-
Great Western United Corp.	-	1,000
Green Giant Company	1,000	1,400
Greyhound Corp.	5,000	5,000
Grumman Corp.	1,000	-
Gulf Oil Corporation	23,000	14,000
Gulf Resources & Chemical Corp.	1,000	1,000
Halliburton Company	2,000	2,000
Hammermill Paper Co.	2,000	2,000

Exhibit 2.02
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NAME	AMOUNT 1975	1974
Hanna Mining Co.	$ 1,000	$ 1,000
Harnischfeger Corp.	1,000	1,000
Harris Corp.	2,500	2,500
Harsco Corporation	2,000	2,000
Hart, Schaffner & Marx	2,000	2,000
Hayes-Albion Corp.	500	1,000
The Hearst Corporation	2,000	2,000
H. J. Heinz Co.	3,500	3,500
Hercules Incorporated	3,500	3,500
Hershey Foods Corp.	2,500	-
Hesston Corp.	1,000	1,000
Heublein, Inc.	3,500	3,500
Hewlett-Packard Co.	2,000	2,000
Hobart Corporation	2,000	2,000
Hoerner Waldorf Corp.	2,000	2,000
Holiday Inns, Inc.	3,000	3,000
Honeywell, Inc.	4,000	4,000
The Hoover Company	1,000	1,000
Houdaille Industries, Inc.	1,500	1,500
Household Finance Corp.	3,000	3,000
Houston Lighting & Power Co.	1,000	1,000
Houston Natural Gas Corp.	1,000	1,000
Houston Oil & Minerals Corp.	1,000	-
Hughes Tool Co.	1,000	1,000
Hyster Company	1,000	1,000

Exhibit 2.02
(page 12 of 25)

NAME	AMOUNT 1975	1974
I-T-E Imperial Corp.	$ 2,500	$ 2,500
IBM Corporation	35,000	35,000
IC Industries	3,500	3,500
Ideal Basic Industries	2,500	2,000
Illinois Tool Works, Inc.	1,000	1,000
Indian Head Inc.	2,500	2,500
Ingersoll-Rand Foundation	3,500	3,500
Inland Container Corp.	2,500	2,000
Inland Steel Company	5,000	3,500
Inmont Corporation	2,000	2,000
Interlake Inc.	2,000	-
International Flavors & Fragrances, Inc.	-	1,000
The International Nickel Co. of Canada, Ltd.	3,000	2,000
International Paper Co.	8,000	5,000
Interpace Corp.	1,000	1,000
Interstate United Corp.	1,000	-
International Harvester Co.	5,000	5,000
International Multifoods Corp.	2,500	2,500
Investors Diversified Services, Inc.	2,500	2,500
The Irvine Company	1,000	1,000
IT&T Corporation	18,000	18,000
Itek Corporation	500	1,000
IU International Corp.	1,000	-
Jefferson-Pilot Corp.	1,000	1,000
Jewel Companies, Inc.	1,000	2,000
John Hancock Mutual Life Insurance Co.	3,500	3,500

Exhibit 2.02
(page 13 of 25)

NAME	AMOUNT 1975	AMOUNT 1974
Johns-Manville Corp.	$ 3,500	$ 3,000
Johnson & Johnson	4,000	4,000
S. C. Johnson & Son, Inc.	2,000	2,000
Johnson Controls, Inc.	1,000	1,000
Jones & Laughlin Steel Corp.	2,500	3,500
Earle M. Jorgensen Co.	1,000	1,000
Joy Manufacturing Co.	2,000	2,000
Kaman Corp.	1,000	1,000
Kaneb Services, Inc.	1,000	-
Kansas City Southern Industries, Inc.	1,000	-
Kellogg Co.	1,000	1,000
Kellwood Co.	1,000	-
Kennametal Inc.	1,000	1,000
Kennecott Copper Corp.	-	1,000
Kewanee Oil Co.	1,000	1,000
Walter Kidde & Co., Inc.	3,500	3,500
Kimberly-Clark Corp.	3,500	3,500
Kirsch Co.	1,000	1,000
Knight-Ridder Newspapers, Inc.	3,000	2,500
Kohler Co.	-	1,000
Koppers Company, Inc.	3,000	3,000
Kraftco Corporation	5,000	4,000
S. S. Kresge Company	6,000	6,000
Kroehler Manufacturing Co.	-	1,000
Laclede Gas Company	1,000	1,000

Exhibit 2.02
(page 14 of 25)

NAME	AMOUNT 1975	1974
Laclede Steel Co.	$ 1,000	$ 1,000
Lear Siegler, Inc.	1,500	1,500
Leeds & Northrup Co.	500	1,000
Lehigh Portland Cement Co.	1,000	1,000
Libbey-Owens-Ford Co.	1,000	1,000
Libby McNeill & Libby	-	1,000
Liggett & Myers Inc.	-	3,500
Lincoln First Banks, Inc.	-	2,000
Lincoln National Corp.	2,000	-
Litton Industries, Inc.	-	6,000
Lockheed Aircraft Corp.	2,000	2,000
Lone Star Gas Company	2,500	2,500
Longview Fibre Company	1,000	1,000
Louisiana Land & Exploration Co.	3,000	-
Louisville Gas & Electric Co.	1,000	1,000
M. Lowenstein & Sons Inc.	2,000	-
The LTV Corporation	1,000	1,000
Lucky Stores, Inc.	2,500	2,500
Lykes-Youngstown Corp.	1,000	1,000
Macmillan, Inc.	1,000	-
Manufacturers National Bank of Detroit	1,000	1,000
Manufacturers Hanover Trust Co.	5,000	10,000
Marathon Oil Company	4,000	4,000
Marcor, Inc.	5,000	5,000
Maremont Corp.	1,000	1,000
Marine Midland Banks, Inc.	3,000	-

Exhibit 2.02
(page 15 of 25)

NAME	AMOUNT 1975	1974
Marriott Corp.	$ 1,000	$ 1,500
Marshall Field & Co.	2,500	-
Martin Marietta Corp.	-	3,000
Masonite Corporation	-	2,000
The Maytag Company	-	1,000
McCormick & Company	1,000	1,000
McDonald's Corp.	2,500	-
McDonnell Douglas Corp.	5,000	5,000
McGraw-Edison Company	2,500	2,500
McGraw-Hill, Inc.	2,000	2,000
MCA, Inc.	3,500	2,500
Melville Shoe Corporation	3,500	3,500
Merck & Company, Inc.	4,000	4,000
Meredith Corporation	1,000	1,000
Metropolitan Life Insurance Co.	6,000	6,000
Michigan National Corp.	-	1,000
Mid-Continental Telephone Corp.	1,000	1,000
Middle South Utilities, Inc.	3,500	-
Midland-Ross Corp.	2,500	2,000
Mine Safety Appliances Co.	1,000	1,000
Minnesota Power & Light Co.	1,000	1,000
Minnesota Mining & Manufacturing Co.	6,000	6,000
Mobil Oil Corp.	23,000	18,000
Mohasco Industries, Inc.	2,500	2,500
Monsanto Company	7,000	5,000
Montana-Dakota Utilities Co.	1,000	-

Exhibit 2.02
(page 16 of 25)

NAME	AMOUNT 1975	1974
Moore McCormick Co., Inc.	$ 2,000	$ 2,000
Morgan Guaranty Trust Co. of New York	14,000	14,000
Morrison-Knudsen Co., Inc.	1,500	1,000
Morton-Norwich Products, Inc.	2,500	2,500
Motorola Foundation	-	2,000
MTD Products	2,500	-
Munsingwear, Inc.	200	1,000
Murphy Oil Corporation	2,000	2,000
Mutual of New York	1,000	-
N. L. Industries, Inc.	3,000	3,000
Nabisco, Inc.	3,500	3,500
Nalco Chemical Co.	2,500	1,500
Nash Finch Company	1,284	1,284
National Airlines, Inc.	500	2,000
NCR Corp.	4,000	3,500
National Gypsum Co.	2,500	2,500
National Life & Accident Insurance Co.	-	1,000
Nationwide Mutual Insurance Co.	1,500	1,500
National Bank of Detroit	2,000	2,000
National Distillers & Chemical	2,000	2,000
National Starch & Chemical Corp.	1,000	1,000
NCNB Corporation	1,000	2,000
Neptune International Corp.	1,000	500
New England Electric System	2,500	-
New York Life Insurance Co.	2,500	2,500

Exhibit 2.02
(page 17 of 25)

NAME	AMOUNT 1975	1974
Norfolk & Western Railway	$ 3,500	$ 3,500
Norris Industries, Inc.	-	2,000
Northeast Utilities Service Co.	3,500	3,500
Northern Illinois Gas Co.	1,000	-
Northwest Bancorporation	3,000	3,000
Northwestern Mutual Life Insurance Co.	1,500	1,500
Northwestern Steel & Wire Co.	2,000	2,000
Norton Company	3,000	-
Norton Simon, Inc.	4,000	4,000
Noxell Corporation	500	1,000
Occidental Petroleum Corp.	6,000	6,000
Olin Corporation	2,500	2,500
Olympia Brewing Company	-	1,000
Onan Corporation	1,000	1,000
Oscar Mayer & Co.,	3,500	3,000
Otis Elevator Company	2,500	2,500
Outboard Marine Corp.	1,000	1,000
Owens-Corning Fiberglas Corporation	3,000	3,000
Owens-Illinois, Inc.	4,000	4,000
Panhandle Eastern Pipe Line Company	3,500	3,500
Peabody Galion Corp.	1,000	1,000
Penn Mutual Life Insurance Co.	1,000	1,000
J. C. Penney Co., Inc.	5,000	10,000
Pennsylvania Power & Light Co.	1,000	1,000
Pennzoil Company	3,500	3,500
Peoples Gas Co.	3,500	-

Exhibit 2.02
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NAME	AMOUNT 1975	1974
Pepsico Foundation, Inc.	$ 4,000	$ 4,000
Pet, Incorporated	3,000	2,500
Petrolane Inc.	1,500	1,000
Pfizer, Inc.	4,000	4,000
Phelps Dodge Foundation	3,500	3,500
Philadelphia Electric Co.	1,000	1,000
Philadelphia National Bank	1,000	2,500
Philip Morris Inc.	3,500	3,500
Phillips Petroleum Co.	8,000	6,000
Pillsbury Co.	1,000	1,000
Pitney-Bowes, Inc.	2,000	2,000
Pittston Co.	3,500	-
Polaroid Corporation	2,500	-
Pope & Talbot, Inc.	1,000	1,000
Potlatch Corporation	2,500	2,500
PPG Industries, Inc.	3,500	3,500
Prentice-Hall, Inc.	1,000	1,000
Procter & Gamble Co.	9,000	9,000
Provident National Bank	2,000	2,000
Prudential Insurance Company of America	6,000	6,000
Public Service Company of Colorado	2,500	2,500
Public Service Electric and Gas	3,000	3,000
Puget Sound Power & Light Co.	2,000	2,000
Pullman Incorporated	1,000	1,500
Purolator, Inc.	1,000	2,000

Exhibit 2.02
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NAME	AMOUNT 1975	1974
The Quaker Oats Co.	$ 3,500	$ 3,500
Ralston Purina Company	4,000	4,000
Raytheon Company	4,000	3,500
Radio Corporation of America	1,000	1,000
Reed Tool Company	1,000	1,000
Reliance Electric Co.	2,000	2,000
Reliance Group, Inc.	500	2,500
Republic National Bank of Dallas	3,500	3,500
Republic Steel Corp.	3,000	3,000
Research-Cottrell, Inc.	-	1,000
Retail Credit Company	1,000	1,000
Revlon, Inc.	2,000	-
Rexnord Inc.	2,000	2,000
R. J. Reynolds Industries, Inc.	5,000	-
Reynolds Metals Co.	3,500	3,500
Richardson-Merrell Inc.	3,000	3,000
Robert Shaw Controls Co.	900	1,000
A. H. Robins Co., Inc.	1,500	1,500
Rockwell International Corp.	4,000	4,000
Rohm & Haas Co.	3,500	3,500
Rohr Industries, Inc.	-	2,000
Roper Corporation	1,250	1,250
Rorer-Amchem, Inc.	1,000	1,000
Roseburg Lumber Company	1,000	1,000
Royal Crown Cola Co.	-	1,000

Exhibit 2.02
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NAME	AMOUNT 1975	1974
Ryan Homes, Inc.	$ 1,000	$ -
Safeco Corporation	500	1,000
Salant Corporation	1,000	1,000
Sandoz, Inc.	1,000	1,000
Savannah Foods & Industries	1,000	1,000
Saxon Industries, Inc.	2,000	-
Schering-Plough Corp.	3,500	3,500
Schlumberger, Limited	3,500	3,500
SCM Corporation	3,000	3,000
Scott Paper Company	2,500	2,500
G. D. Searle & Company	3,500	2,500
Sears, Roebuck & Co.	18,000	18,000
Seattle First National Bank	2,000	2,000
Security Bank & Trust Co.	100	1,000
Security Pacific National Bank	2,500	2,500
Servomation Corporation	500	1,000
Shawmut Association, Inc.	3,500	3,500
Shell Oil Company	9,000	9,000
Sheller-Globe Corp.	1,000	-
The Sherwin Williams Co.	3,000	3,000
The Signal Companies	1,750	3,500
Signode Corp.	1,000	1,000
The Singer Company	4,000	5,000
Skelly Oil Company	1,700	1,700
A. O. Smith Corp.	2,500	2,500
Smith International, Inc.	1,000	1,000

Exhibit 2.02
(page 21 of 25)

NAME	AMOUNT 1975	1974
Smithkline Corp.	$ 3,000	$ 1,500
Southdown, Inc.	2,000	-
Southern California Gas	3,000	3,500
Southern Union Gas Co.	1,000	1,000
Southland Corp.	1,000	1,000
Southern Natural Resources, Inc.	1,000	1,000
Southwest Forest Industies, Inc.	1,000	2,000
Sperry & Hutchinson Co.	2,000	-
Sperry Rand Corp.	1,000	1,000
Spraque Electric Co.	1,000	1,000
Squibb Corporation	2,000	2,000
St. Louis-San Francisco Railway	1,000	1,000
St. Paul Companies, Inc.	3,000	3,000
St. Regis Paper Company	3,000	3,000
A. E. Staley Manufacturing Co.	2,000	-
Standard Oil Co. of California	18,000	18,000
Standard Oil Co. (Indiana)	14,000	14,000
Standard Oil Co. - Ohio	3,500	3,500
Standard Pressed Steel Co.	1,000	-
Stanley Home Products	1,000	1,000
The Stanley Works	1,000	1,000
Stauffer Chemical Co.	3,000	3,000
Sterling Drug Inc.	1,000	1,000
J. P. Stevens & Company, Inc.	3,000	3,000
Stewart-Warner Corp.	1,000	-
Storer Broadcasting Co.	1,000	1,000

Exhibit 2.02
(page 22 of 25)

NAME	AMOUNT 1975	1974
Sun Oil Company	5,000	5,000
Sunbeam Corporation	1,000	1,000
Sundstrand Corp.	1,000	1,000
The Superior Oil Co.	1,000	1,000
Supermarkets General Corp.	-	1,500
Supervised Investors Services	100	1,000
Sybron Corporation	2,500	-
Taft Broadcasting Co.	1,000	-
James Talcott, Inc.	-	2,000
Talley Industries, Inc.	2,000	-
Tasty Baking Company	1,000	1,000
Tektronix, Inc.	1,000	1,000
Tenneco Inc.	6,000	6,000
Tesoro Petroleum Corp.	3,500	1,000
Texaco Inc.	25,000	35,000
Texas Eastern Transmission Co.	3,500	3,500
Texas Gas Transmission Corp.	3,000	3,000
Texas Industries, Inc.	1,000	1,000
Texas Instruments Inc.	3,500	3,500
Texas Gulf Inc.	-	2,000
Textiles Inc.	1,000	1,000
Textron Inc.	2,000	2,000
Thiokol Chemical Corp.	500	1,000
T I Corporation of California	1,000	1,000
Time, Inc.	3,000	3,500

Exhibit 2.02
(page 23 of 25)

NAME	AMOUNT 1975	1974
Times Mirror Company	3,500	3,500
The Timken Company	3,000	3,000
The Torrington Company	1,000	1,000
Trans Union Corp.	2,500	2,500
Transamerica Corp.	4,000	4,000
Transcontinental Gas Pipeline Corp.	–	3,500
Travelers Insurance Co.	2,500	2,500
Trust Company of Georgia	500	1,000
TRW, Incorporated	4,000	4,000
Twin Disc Inc.	1,000	1,000
Tyler Corporation	1,000	1,000
United States Borax & Chemical Corp.	1,000	1,000
United States Gypsum Co.	2,500	2,500
United States Industries, Inc.	4,000	4,000
United States Bancorp	1,000	1,000
United States Steel Corp.	15,000	10,000
United States Trust Company of New York	500	1,000
UMC Industries, Inc.	–	1,000
Union Bank	1,000	1,000
Union Camp Corp.	1,500	–
Union Carbide Corp.	8,000	8,000
Union Electric Co.	1,000	–
Union Oil Company of California	7,500	5,000
Union Pacific Corp.	4,000	4,000
Union Planters National Bank	500	1,200

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Exhibit 2.02
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NAME	AMOUNT 1975	1974
Uniroyal Inc.	$ 3,500	$ 3,500
United Air Lines, Inc.	1,000	1,000
United Aircraft Corp.	2,000	2,000
United Brands Co.	1,000	1,000
United California Bank	5,000	5,000
United Merchants & Manufacturing, Inc.	-	1,500
United Telecommunications, Inc.	-	3,500
Universal Leaf Tobacco Co. Inc.	1,000	1,000
Universal Oil Products Co.	3,000	2,500
Upjohn Co.	1,500	3,500
USM Corporation	1,000	2,000
Utah International Inc.	2,500	2,500
Varian Associates	1,000	1,000
Vendo Co.	-	1,000
Victor Comptometer Corp.	500	1,000
Vulcan Materials Co.	2,000	2,000
Wallace-Murray Corp.	2,000	2,000
Jim Walter Corp.	-	3,500
Warnaco, Inc.	2,000	2,000
The Warner & Swasey Co.	1,000	1,000
Warner Communications Inc.	2,500	3,000
Washington Natural Gas Co.	1,000	1,000
Washington Post Co.	2,000	2,000
Weil-McLain Co.	1,000	1,000
Wells Fargo & Co.	2,000	2,000

Exhibit 2.02
(page 25 of 25)

NAME	AMOUNT 1975	1974
West Penn Power Co.	$ 1,500	$ 1,500
West Point-Pepperell	2,500	2,500
Western Bancorporation	3,000	3,000
Western Electric Co., Inc.	14,000	14,000
Western Publishing Co.	2,000	2,000
Westinghouse Electric Corp.	9,000	9,000
Westvaco Corporation	2,500	2,500
Weyerhaeuser Company	5,000	5,000
Wheelabrator-Frye Inc.	1,000	1,000
Whirlpool Corporation	3,500	4,000
White Motor Corporation	3,000	3,000
Wickes Corp.	1,000	1,000
The Williams Companies	3,500	2,500
Winn-Dixie Stores, Inc.	1,000	1,000
Witco Chemical Corporation	1,000	-
Work Wear Corp.	500	1,000
WM Wrigley Jr Co.	2,000	1,000
Xerox Fund	6,000	6,000
Yellow Freight System, Inc.	2,000	2,000
Zapata Corp.	2,000	2,000
Zayre Corp.	2,000	2,000
Total contributions of $1,000 or more	$1,746,984	$1,747,134
Total contributions less than $1,000	181,365	152,035
TOTAL	$1,928,349	$1,899,169
Number of contributors of $1,000 or more	580	569
Number of contributors of less than $1,000	817	655
TOTAL	1,397	1,224

Exhibit 2.03

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Contributions Received from Other Sources
for the Years Ended December 31, 1975 and 1974

NAME	AMOUNT 1975	AMOUNT 1974
Individual contributions of $1,000 or more (Note 1):		
American Accounting Association	$ 6,876	$10,000
Financial Analysts Federation	7,000	-
National Association of Accountants	75,000	28,500
New York Stock Exchange	50,000	50,000
Liberty Fund	2,000	-
Stanford University	-	1,000
Total Contributions of $1,000 or more	140,876	89,500
Total Contributions of less than $1,000	900	5,542
Total	$141,776	$95,042
Number of Contributors of $1,000 or more	5	4
Number of Contributors of less than $1,000	9	176
Total	14	180

Note 1: Details regarding contributions of less than $1,000 are not included since, in the aggregate, they are not significant.

Exhibit 3
(page 1 of 3)

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Memberships Held by Trustees of the Financial Accounting Foundation and Members of the Financial Accounting Standards Board and Financial Accounting Standards Advisory Council in the Foundation's Sponsoring Organizations as of May 15, 1976 (Note 1)

	Foundation's Sponsoring Organizations				
	AAA	AICPA	FAF	FEI	NAA
Financial Accounting Foundation					
Richard T. Baker	x	x	-	-	x
John C. Biegler	-	x	-	-	-
Ivan O. Bull	-	x	-	-	-
James Don Edwards	x	x	-	x	x
William H. Franklin	-	x	-	-	x
Ralph E. Kent	x	x	-	-	x
Stanley J. Scott	-	x	-	-	-
Walter P. Stern	-	-	x	-	-
Wilbert A. Walker (Note 2)	-	x	-	x	-
Financial Accounting Standards Board					
Marshall S. Armstrong	-	x	-	-	-
Oscar S. Gellein	x	x	-	-	-
Donald J. Kirk	-	x	-	-	-
Arthur L. Litke	x	x	x	-	x
Robert E. Mays	-	x	-	x	-
Walter Schuetze	x	x	-	-	-
Robert T. Sprouse	x	-	-	-	-

Note 1: Amendments to the Certificate of Incorporation and By-Laws of the Financial Accounting Foundation are presently under consideration. If effected, such amendments would in essence increase the size of the Board of Trustees from 9 to 11 and would add one sponsoring organization.

Note 2: Resigned effective September 30, 1976.

Exhibit 3
(page 2 of 3)

Financial Accounting Standards Advisory Council	Foundation's Sponsoring Organizations				
	AAA	AICPA	FAF	FEI	NAA
Andrew Barr	x	x	-	-	x
Norton M. Bedford	x	x	-	-	x
William E. Buxbaum	-	-	-	x	-
George R. Catlett	x	x	-	-	x
Joseph P. Cummings	x	x	-	-	x
J. O. Edwards	-	x	-	x	-
Frank Forester, Jr.	-	-	-	x	-
Charles G. Gillette	-	x	-	-	x
John A. Grady	-	x	-	-	-
Charles C. Hornbostel	-	-	-	x	-
Charles T. Horngren	x	x	-	-	x
Allan Kramer	-	-	-	-	-
Harold Q. Langenderfer	x	x	-	x	x
Raymond C. Lauver	x	x	-	-	x
Robert A. Malin	-	-	x	-	-
Robert K. Mautz	x	x	-	-	-
Charles T. McGarraugh	-	-	-	-	-
Robert A. Morgan	x	-	-	x	x
James W. Nethercott	-	-	-	x	-
William C. Norby	-	x	x	x	-
David Norr	x	x	x	-	-
Richard C. O'Sullivan	-	-	-	x	-
Elmer B. Staats	-	-	-	-	-
Frances Stone	-	-	x	-	-

Exhibit 3
(page 3 of 3)

Financial Accounting Standards Advisory Council (concluded)	AAA	AICPA	FAF	FEI	NAA
	Foundation's Sponsoring Organizations				
E. Palmer Tang	x	x	-	-	-
Robert C. Thompson	-	-	-	x	-
Allan Wear	-	x	-	x	-
Charles A. Werner	-	x	-	-	-
Francis M. Wheat	-	-	-	-	-
John C. Whitehead	-	-	-	-	-
John A. Willis	-	-	-	x	x
Total	18	30	6	15	15

Exhibit 4
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FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Explanation of the Restrictions on
Outside Financial Interests Mandated
in Section 4, Article II-A of the
By-Laws of the
Financial Accounting Foundation

A. Background

The Financial Accounting Standards Board (see also Description of the Organization) resulted from recommendations contained in a report, following comprehensive study and review for over a year, issued in 1972 by a study group chaired by a former Commissioner of the Securities and Exchange Commission and comprised of three certified public accountants, an accounting educator, a financial executive, and an investment banker.

The study group concluded, after considering much data, testimony, and varying points of view, that responsibility for establishing financial accounting and reporting standards should remain in the private sector, but that certain fundamental changes were needed.

Acknowledging that the APB, as a senior committee of the AICPA, represented in the fullest sense self-regulation by the accounting profession of its members and its principal function of establishing and improving standards for the guidance of the profession, the study group found that:

1. The public was uncertain that the APB, a part-time, voluntary body of 18 AICPA members, could truly maintain freedom from client and other pressures.

2. A part-time body, however dedicated, could not devote itself continuously and single-mindedly to the problems at hand.

3. While establishing standards for the accounting profession necessarily required dominant participation by the profession being regulated, the perspective and the work of the standards-setting body would be benefited by the participation of others with a variety of complementary and relevant skills.

The fundamental structure of the FASB, and its authority over establishing and improving standards of financial accounting and reporting, represent solutions to the study group's principal findings. Thus, the Financial Accounting Standards Board has seven salaried, full-time members serving for terms of five years with possible renewal for a second term. During their terms of office, Board members may not have any continuing proprietary, investment, economic or pecuniary relationship in, or association with, any firm, company, corporation or organization, other than as permitted by personnel policies adopted by the Foundation's Board of Trustees or otherwise as specifically permitted by the Trustees. Four of the seven members of the Board must be certified public accountants from public practice, and the other three must have extensive experience in the financial accounting and reporting field (presently a former accounting educator, corporate accounting executive, and Chief, Office of Accounting & Finance, of the Federal Power Commission).

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(page 3 of 9)

The Board's authoritative pronouncements -- Statements of Financial Accounting Standards and Interpretations -- are enforced against the accounting profession through Rule of Conduct 203 of the AICPA's Code of Professional Ethics. Thus, a member of the AICPA may not express an opinion that financial statements are presented in conformity with generally accepted accounting principles if such financial statements contain any departure from an accounting principle or standard issued by the FASB or the APB (or its predecessor) unless the member can demonstrate that due to unusual circumstances the financial statements would otherwise be misleading.

The Securities and Exchange Commission issued Accounting Series Release No. 150 on December 20, 1973, in which it noted that it had endorsed the establishment of the FASB in 1972 in the belief that the Board would provide an institutional framework which would permit prompt and responsible action flowing from research and consideration of varying viewpoints. Reiterating its own authority and responsibilities under the Federal Securities Laws, and its intent to continue vigorously to carry out its Congressional mandate, the Commission restated its policy that where the Commission and a registrant differed as to proper accounting, disclosure would be accepted in lieu of changing the financial statements only if substantial authoritative support existed for the registrant's accounting and the Commission's position had not been expressed in its rules, regulations or releases. The Commission then stated it would consider principles, standards and practices promulgated by

the FASB and the APB (and its predecessor) in their authoritative pronouncements as having substantial authoritative support; and that those contrary to such promulgations would be considered as having no support; and, in the absence of unusual circumstances, financial statements prepared on such other basis would not be accepted for filing.

In light of the Board's public responsibilities and in order to assure the continuing integrity, independence and objectivity of Board members and the Board's technical and administrative staffs, the Foundation's Board of Trustees and the Chairman of the FASB have issued strict policies governing personal activities, investments and conduct. These policies are based on the premise that there can be no conflict, or the appearance of any conflict, between a Board or staff member's private interests on the one hand, and the public interest and his duties to the Financial Accounting Foundation and the FASB on the other.

Moreover, these policies recognize that each Board and staff member must at all times be mindful of his public responsibilities, the sensitivity of his position, and the need for public confidence in the fairness and objectivity of the deliberative processes of the Standards Board. Accordingly, care was taken in the formulation of the policies and related questionnaire and affirmation (see Exhibits 4.01 and 4.02) to make it abundantly clear to each person affected that he must conduct

all of his activities in such a manner as not to be detrimental to the interests or repute of the Foundation or the Board, or so as to impair his independence or objectivity.

These policies further make it clear that each Board and staff member must recognize that independence and objectivity are in large measure subjective, rather than objective, qualities when viewed by the public, and, accordingly, public confidence in the functions and activities of the Foundation and the Standards Board depend significantly upon scrupulous observance of the letter, and the spirit, of these policies.

B. Personnel Policies

Included in Exhibit 4.01 is a copy of "Policies in Respect of Investments, Personal Activities, Speeches and Publications of Members and Directors of the Financial Accounting Standards Board," and the related form of Questionnaire relating to investments and personal activities, adopted by the Board of Trustees of the Financial Accounting Foundation on December 13, 1973 pursuant to Section 4 of Chapter A, Article II-A, of the Foundation's By-Laws (hereinafter the "Trustees' Policies").

Included as Exhibit 4.02 is a copy of "Policies in Respect of Personal Activities, Speeches and Publications of Members of the Staff of the Financial Accounting Standards Board," and a related affirmation required of staff members, originally issued by the Chairman of the Standards Board on March 28, 1974 pursuant to Section 11 of Chapter A, Article II-A of the Foundation's By-Laws (hereinafter the "Staff Policies").

The foregoing Trustees' Policies may be summarized as follows:

1. Trustees' Policies - applicable to Board Members and the Directors of Research and Technical Activities, Emerging Problems, and Administration.

(a) No Board Member or director may be owed any financial or other obligation, directly or indirectly, by any former employer or client, including, without limitation, retirement and deferred benefits and separation payments, other than certain vested or otherwise "fixed" annuity-type payments. Excepted from this prohibition are normal banking relationships, ownership of governmental securities or traded securities, and certain other limited investments. Material investments* must be disclosed in an annual questionnaire, and questionnaires must be updated as changes occur.

(b) Prior to advising the Trustees of intent to resign or not to stand for reappointment, no Board Member or director may have any formal or informal arrangement or understanding with any person with respect to any employment, consulting or other arrangement or affiliation after termination of his relationship with the Board.**/***

(c) No Board Member or director may have any financial or other obligation to any former employer, business relationship or client, other than normal banking relationships, covenants not to compete and obligations of a comparable character.

*Securities of a particular issuer equal to or exceeding the greater of $25,000 or 10% of the respondent's net worth. (See Exhibit 4.01.)

**George J. Staubus, a professor at the University of California, will become Director of Research and Technical Activities on or about July 1, 1976 under a leave of absence.

***See page 7 for explanation.

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(page 7 of 9)

(d) Board members and directors may have investments as indicated in (a) above, but they are required at all times to be mindful of the public character of their responsibility and to take steps to minimize any financial involvement which could be regarded as affecting their independence or objectivity. Each Board Member and director is also required to be sensitive to the possibility that material financial or other arrangements involving his spouse or family members could also affect his independence and objectivity. Each Board Member and director is urged to consult with a committee of the Foundation's Trustees in the event he should feel that he, his spouse or family members may have a direct financial interest or a material indirect financial interest or relationship which could affect his independence or objectivity.

(e) Each Board Member and director must devote his full business time to the activities of the Standards Board, and not engage in any outside activity which interferes with the performance of his duties. Further, no Board Member or director may be affiliated as a partner, director, trustee, officer, employee, agent or consultant with respect to any organization, other than a non-profit organization (with limited exceptions involving essentially family matters), and no affiliations with non-profit organizations may exist which interfere to any material degree with devoting his full business time to the performance of his duties, or which affect his independence or objectivity.

***Board Member Walter Schuetze has submitted his resignation from the FASB effective July 1, 1976, and expressed his intent to rejoin Peat, Marwick, Mitchell & Co..

(f) Board Members and directors may not, directly or indirectly, use or otherwise place themselves in a position to benefit personally from, or to disclose or make available to others, any information which might be regarded as material relating to the functions or activities of the Foundation or the Standards Board which has not been made available publicly.

(g) While Board Members and directors may make speeches and write for publication, any fees, honorariums or payments, other than reimbursement for out-of-pocket expenses, must be paid over to the Foundation.

(h) Each Board Member and director is required to sign an annual questionnaire representing that he has received and read carefully the Trustees' Policies and that he agrees to conduct his affairs and activities in accordance with such Policies. Such questionnaire provides, by means of a schedule, for each Board Member and director to set forth information as to investments by himself and members of his family group. Each Board Member and director is required to file a new questionnaire annually and to amend his most recent questionnaire if at any time prior to his annual filing his response does not accurately reflect subsequent developments, including matters involving investments.

2. Staff Policies - applicable to all other technical and administrative employees.

The Staff Policies, issued by the Chairman of the Standards Board, are essentially to the same effect as the

Exhibit 4
(page 9 of 9)

Trustees' Policies applicable to Board Members and directors, though recognizing, in terms of activities and investments, the lesser degree of involvement and sensitivity of staff positions in the process of formulating financial accounting and reporting standards.* (See Exhibit 4.02.)

3. Violation of Personnel Policies

Both the Trustees' Policies and the Staff Policies provide that violations of such Policies and rules of conduct may, in the discretion of the Trustees of the Foundation in case of Board Members and directors and in the discretion of the Chairman of the FASB in the case of other staff members, be deemed conduct detrimental to the purposes and repute of the Standards Board and constitute grounds for removal or involuntary termination.

No occasion has arisen to date requiring or resulting in disciplinary action under the Trustees' Policies or the Staff Policies.

*The Staff Policies are not required by the By-Laws of the Foundation. They were nevertheless issued by the Chairman of the FASB as a means of further assuring the integrity, independence and objectivity of the Board.

Exhibit 4.01
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December 13, 1973

FINANCIAL ACCOUNTING FOUNDATION

POLICIES IN RESPECT OF INVESTMENTS,
PERSONAL ACTIVITIES, SPEECHES AND PUBLICATIONS
OF MEMBERS AND DIRECTORS OF THE FINANCIAL
ACCOUNTING STANDARDS BOARD; [and Questionnaire Relating to
Investments and Personal Activities]

A. Introduction. These Policies have been adopted pursuant to Section 4 of Article II-A of the By-Laws of the Financial Accounting Foundation (the "Foundation"), and may from time to time be altered, amended, supplemented and repealed, by the Board of Trustees of the Foundation (the "Trustees"). Unless otherwise stated herein, these Policies apply to the members of the Financial Accounting Standards Board (the "Standards Board") and to the Directors of Administration and Research of the Standards Board. The members of the Standards Board and the Directors of Administration and Research are sometimes hereinafter referred to as "Members" and "Directors", respectively.

B. General Policy. One of the principal reasons behind the organization of the Foundation was to establish to public satisfaction the independence and objectivity of those responsible for establishing and improving standards of financial accounting and reporting. Therefore, it is of the utmost importance that there be no conflict between a Member's

Exhibit 4.01
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or a Director's private interests, on the one hand, and the public interest and his duties to the Foundation and Standards Board, on the other.

Each Member and Director should at all times be mindful of his public responsibilities, the sensitivity of his position, and the need for public confidence in the fairness of the deliberative process of the Standards Board, and, accordingly, should take great care to conduct himself and all his activities in such a manner so that his investments, personal activities, speeches and publications will not affect his independence or objectivity or be detrimental to the interests or repute of the Foundation or the Standards Board. In this regard, each Member and Director should recognize that independence and objectivity are in large measure subjective, rather than objective, qualities, and that reasonable people assessing like facts can in good faith reach different conclusions as to their existence, or non-existence, in a particular case. Accordingly, the degree of public confidence in the functions and activities of the Foundation and the Standards Board will depend significantly upon scrupulous observance of the letter and spirit of these Policies.

In furtherance of the foregoing, Section 4 of Article II-A of the Foundation's By-Laws provides, among other things, that "no member of the [Standards Board] shall

have any continuing proprietary, investment, economic or pecuniary relationship in, or association with, any firm, company, corporation or organization other than the Foundation, except as permitted [by these Policies] or with the specific permission of the Trustees [of the Foundation]." The Trustees by these Policies are permitting certain relationships and associations other than with the Foundation, and are also extending these Policies to the Directors of Administration and Research of the Standards Board. As mentioned in Paragraph E. below, all or any part of these Policies may from time to time be extended to, or other Policies may be adopted for, other staff personnel by the Chairman of the Standards Board.

The following Rules of Conduct and Personnel Procedures are designed and will be interpreted in a manner to avoid potential conflicts of interest.

C. Rules of Conduct. In order to promote compliance with the General Policy stated above, the following Rules of Conduct are applicable to Members and Directors. As provided in Paragraph D.5. hereof, Members and Directors are required to supply periodic information and other data to the Trustees with respect to their investments and personal activities.

1. Relationships with Employers, Partnerships and Clients; Family Interests. During the term of a Members's or Director's employment relationship with the Foundation or the Standards Board,

Exhibit 4.01
(page 4 of 22)

(a) no financial or other obligations shall be owed, directly or indirectly, to such Member or Director by any former employer, business partnership or client. For purposes of the foregoing, such financial or other obligations shall not include obligations arising from normal banking relationships or by virtue of a Member or Director investing as a limited partner in an investment vehicle or owning or holding securities issued by any government or governmental agency or listed on a national securities exchange or traded in the over-the-counter market, but shall include, without limitation, retirement and deferred benefits and payments resulting from separation, other than fixed amounts or fixed annuities. An annuity shall be deemed "fixed" if it is (i) vested prior to employment by the Foundation or the Standards Board, (ii) payable over a fixed term or the life or lives of the Member or Director, his spouse or other persons, and (iii) not materially affected as to amount by the results of operations or financial position of any such former employer, business partnership or client on a going concern basis;

(b) no Member or Director shall have any formal or informal agreement, arrangement or understanding with any person to the effect that after termination of his employment relationship with the Foundation or the Standards Board he can or will return to, or become affiliated with, an employer or business partnership, or resume or enter into consulting or other similar arrangements; and

(c) no Member or Director shall have any financial or other obligations to any former employer, business relationship or client. For purposes of the foregoing, such obligations shall not be deemed to include obligations arising from normal banking relationships, covenants not to compete or as to divulgence of trade secrets or proprietary rights, or obligations of a comparable character.

Each Member and Director should also be sensitive to the possibility that material financial or other arrangements involving his spouse or family members* could also affect his independence and objectivity.

2. Investments. Subject to Paragraph C.1(a) above, investments, including the owning or holding of securities; by Members, Directors, their spouses and their family members are not prohibited by these Policies. However, Members and Directors should at all times be mindful of the public character of their responsibilities and should take care to avoid, and wherever possible take steps as may be reasonably practicable in the circumstances to minimize, financial involvement which could affect their independence or objectivity. With regard

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* For purposes of these Policies, a "family member" shall be deemed to mean any relative of the Member or Director or relative of his spouse, sharing his home.

to the foregoing and as provided in Paragraph D.3. hereof, each Member and Director is urged to consult with the Committee of Trustees at the earliest possible time if he feels that he, his spouse or family members may have a direct financial interest or a material indirect financial interest, or other relationship, which could affect his independence or objectivity.

3. Outside Activities. Each Member and Director is expected to devote his full business time to the activities of the Standards Board, and shall not engage in any outside activity which interferes with the performance of his duties to the Standards Board. Further, and except as hereinafter permitted, no Member or Director may be affiliated as a partner (other than investing as limited partner in investment vehicles), director, trustee, officer, employee, agent or consultant with respect to any organization, other than a non-profit organization; provided, however, that no Member or Director shall have any affiliations with non-profit organizations which interfere to any material degree with his devoting his full business time to the performance of his duties to the Foundation and the Standards Board, or affect his independence or objectivity. Notwithstanding the foregoing, Members and Directors may serve as directors or officers of family or personal investment holding companies, or as executors, administrators, guardians, trustees of inter

vivos or testamentary trusts, custodians for minors or in similar representative capacities, subject in all cases to the limitations set forth above with respect to affiliations with non-profit organizations.

4. Non-Public Information. Members and Directors shall not, directly or indirectly, use or otherwise place themselves in a situation to benefit personally from, or, directly or indirectly, disclose or make available to others (other than as required by their employment and duties), any information which might be regarded as material relating to the functions or activities of the Foundation or the Standards Board obtained in the course of their employment and which has not been released or announced or otherwise made available publicly.

5. Speeches and Publications. Members and Directors may make speeches and write for publication. However, a copy of each speech and writing shall be made available to the Chairman of the Standards Board for comments in advance of delivery or first publication. Members and Directors may accept reimbursement for out-of-pocket expenses incurred in connection with any such speech or writing, but any fees, honorariums or other payments in connection therewith shall be remitted or paid over to the Foundation. Notwithstanding

the foregoing, however, Members and Directors may receive royalties or other like payments in respect of writings completed prior to commencement of their employment relationship with the Foundation or the Standards Board.

D. Personnel Procedures

1. Removal and Involuntary Termination. Section 3 of Article II-A of the By-Laws of the Foundation provides that a Member may be removed from office by the vote of two-thirds of all Trustees then serving, by reason of disability for six consecutive months, for malfeasance or alleged malfeasance in office, or for conduct detrimental to the purposes or repute of the Standards Board.

Section 11 of Article II-A of the By-Laws of the Foundation empowers the Chairman of the Standards Board to hire, retain and contract with staff personnel of the Standards Board, including the Directors of Administration and Research. Staff personnel hired, retained, appointed or contracted for by the Chairman serve at the pleasure of the Chairman or as otherwise provided in contracts made by or at his direction.

Violations by a Member or Director of the General Policy or a Rule of Conduct set forth above may, in the discretion of the Trustees or, in the case of the Directors of Administration and Research, the Chairman of the Standards Board, be deemed to be conduct detrimental to the purposes

or repute of the Standards Board and constitute grounds for removal or involuntary termination.

2. Retirement, Resignation and Voluntary Termination. With respect to Members, Section 5 of Article II-A of the By-Laws of the Foundation provides that the issuance of Statements of Financial Accounting Standards, Interpretations (as defined in the By-Laws) and exposure drafts require the prior approval of at least five Members, except in the case of vacancy, disability of any duration or character, or in the event a Member disqualifies himself from voting for reasons related to these Policies. In view of the importance and public significance of the powers, functions and activities of the Standards Board, and in order to permit a thorough review and investigation of possible replacements or successors, the Trustees expect that any Member considering retirement, resignation, or voluntary termination of his appointment, prior to the expiration of his term or at the expiration of his term, if he is eligible for reappointment, will so advise the Chairman and the Trustees at the earliest possible date, preferably on a least six months' notice.

Similar considerations apply to the Directors of Administration and Research. Thus, the Trustees expect that any Director considering retirement, resignation or voluntary termination of employment will so advise the Chairman of the Standards Board at the earliest possible date, preferably on at least three months' notice.

3. Disqualification. If circumstances exist or arise which cause a Member or a Director to feel that he, his spouse or a family member may have a direct financial interest or a material indirect financial interest, or other relationship which could affect such Member's or Director's independence or objectivity in respect of the Foundation, the Standards Board or their purposes, functions or current activities, he should, at the earliest possible time, disclose such circumstances and all pertinent facts to one or more members of the Committee of Trustees referred to in Paragraph D.4 hereof, make himself available as requested for consultations with the Committee as to such circumstances and facts, and file with the Committee such data as the Committee shall reasonably request. If as a result of such consultations such Member or Director should decide that he should disqualify himself from a vote or from specific functions or activities, he shall, at the earliest possible time, so notify the Trustees and the Chairman. Notification at the earliest possible time is particularly important if disqualification involves a vote on an exposure draft or a Statement or Interpretation.

With respect to Members, it should be noted that Section 5 of Article II-A of the By-Laws of the Foundation provides that notwithstanding a Member disqualifying himself from voting, he may nevertheless continue to participate in

public hearings and otherwise during the research, discussion and deliberative periods. However, in view of the importance and public signficance of the powers, functions and activities of the Standards Board, Members should consider thoroughly, and consult to the fullest extent, with the Committee before deciding to disqualify themselves on a particular vote.

4. Committee of Trustees. As contemplated by Section 6 of Article I-A of the By-Laws of the Foundation and as stated above, a Committee of Trustees has been appointed to consider, among other things, matters arising under these Policies, including consultations with Members and Directors in respect of whether any such Member or Director should disqualify himself from a vote or from specific functions or activities. This Committee will report periodically to the Trustees as they may require, and is free to consult with the Trustees at any time at the Committee's discretion.

5. Information Concerning Members and Directors. Until further notice by the Trustees or the Committee referred to above, Members and Directors shall supply the periodic information and data to the Committee with respect to their investments in securities and personal activities by completing and filing the attached Questionnaire with the Committee. Any enumeration or listing of investments in securities shall not be deemed to create a presumption that such investments, or

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any of them, affect the independence or objectivity of the responding Member or Director.

E. Personnel Policies for Other Staff Personnel

From time to time the Chairman of the Standards Board may extend all or any part of these Policies to, or may adopt other Policies for, such other staff personnel of the Standards Board as he may determine. In the event of any such extension or adoption of Policies, the Chairman shall be responsible for the implementation and administration thereof and shall have full authority with respect to all matters arising thereunder. The Chairman shall report periodically to the Committee of Trustees referred to in Paragraph D.4. as it may require, and is free to consult with such Committee at any time at his discretion.

(Questionnaire retained in Committee files)

Exhibit 4.02
(page 1 of 6)

Internal Policy Bulletin

FASB

File Reference 1.07

POLICIES IN RESPECT OF PERSONAL ACTIVITIES, SPEECHES AND PUBLICATIONS OF MEMBERS OF THE STAFF OF THE FINANCIAL ACCOUNTING STANDARDS BOARD; [and Affirmation]

A. Introduction. These Policies have been established by the Chairman of the Financial Accounting Standards Board (the "Standards Board") pursuant to Section 11 of Article II-A of the By-Laws, and delegation by the Board of Trustees, of the Financial Accounting Foundation (the "Foundation"), and may from time to time be altered, amended, supplemented and repealed by him. Unless otherwise stated herein, these Policies apply to all members of the staff of the Standards Board other than the Staff Directors, including acting Staff Directors, to whom policies adopted by the Trustees of the Foundation apply.

B. General Policy. One of the principal reasons behind the organization of the Foundation and the Standards Board was to establish to public satisfaction the independence and objectivity of those responsible for establishing and improving standards of financial accounting and reporting. Therefore, it is of the utmost importance that there be no conflict between a staff member's private interests, on the one hand, and the public interest and his duties to the Foundation and the Standards Board, on the other.

Each member of the staff should at all times be mindful of the Standards Board's public responsibilities, the sensitivity of its work, and the need for public confidence in the fairness

4/76 (Restates policy issued on 3/28/74. Only changes in certain nomenclature were made.)

of its deliberative process; and, accordingly, should take great care to conduct himself and all his activities in such a manner so that his personal activities, speeches and publications will not affect his independence or objectivity or be detrimental to the interests or repute of the Foundation or the Standards Board. In this regard, each member of the staff should recognize that independence and objectivity are in large measure subjective, rather than objective, qualities, and that reasonable people assessing like facts can in good faith reach different conclusions as to their existence, or non-existence, in a particular case. Accordingly, the degree of public confidence in the functions and activities of the Foundation and the Standards Board depends significantly upon scrupulous observance of the letter and spirit of these Policies.

The following Rules of Conduct and Personnel Procedures are designed and should be interpreted in a manner to avoid potential conflicts of interest.

C. Rules of Conduct. In order to promote compliance with the General Policy stated above, the following Rules of Conduct are applicable to members of the staff.

1. Personal Financial Involvements. Members of the staff should at all times be mindful of the public character of their responsibilities and should take care to avoid, and wherever possible take steps as may be reasonably practicable in the circumstances to minimize, financial involvement which could affect their independence or objectivity. With regard to the foregoing, each member of the staff is urged to consult with the Chairman of the Standards Board at the earliest possible time if he feels

Exhibit 4.02
(page 3 of 6)

that he, his spouse or family members may have a direct financial interest or a material indirect financial interest, or other relationship, which could affect his independence or objectivity.

2. Outside Activities. Each member of the staff is expected to devote his full business time to the activities of the Standards Board, and shall not engage in any outside activity which interferes with the performance of his duties to the Standards Board, or which in any way may be, or appear to be in conflict with the staff member's responsibilities to the Standards Board. Each member of the staff is urged to consult with the Chairman of the Standards Board at the earliest possible time if he feels that he is involved in an outside activity which might conflict with his responsibilities to the Standards Board.

3. Non-Public Information. Members of the staff shall not, directly or indirectly, use or otherwise place themselves in a situation to benefit personally from, or, directly or indirectly, disclose or make available to others (other than as required by their employment and duties), any information which might be regarded as material relating to the functions or activities of the Foundation or the Standards Board obtained in the course of their employment and which has not been released or announced or otherwise made available publicly.

4. Speeches and Publications. Members of the staff may make speeches and write for publication. However, a copy of each speech and writing shall be made available to the office of the Chairman of the Standards Board for comments in advance of delivery or first publication. Staff members may accept

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reimbursement for out-of pocket expenses incurred in connection with any such speech or writing, but any fees, honorariums or other payments in connection therewith shall be remitted or paid over to the Foundation. Notwithstanding the foregoing, however, members of the staff may receive royalties or other like payments in respect of writings completed prior to commencement of their employment relationship with the Foundation or the Standards Board.

D. Personnel Procedures

1. Removal and Involuntary Termination. Section 11 of Article II-A of the By-Laws of the Foundation empowers the Chairman of the Standards Board to hire, retain and contract with staff personnel of the Standards Board. Staff personnel hired, retained, appointed or contracted for by the Chairman serve at the pleasure of the Chairman or as otherwise provided in contracts made by or at his direction.

Violations by a staff member of the General Policy or a Rule of Conduct set forth above may, in the discretion of the Chairman of the Standards Board, be deemed to be conduct detrimental to the purposes or repute of the Standards Board and constitute grounds for involuntary termination of employment.

2. Retirement, Resignation and Voluntary Termination. The Chairman of the Standards Board expects that any member of the staff considering retirement, resignation or voluntary termination of employment is to advise his immediate supervisor at the earliest possible date, preferably on at least two months notice.

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The immediate supervisor, in turn, is to notify the Director of Administration.

# # #

Marshall S. Armstrong
Chairman of the Board

(Staff note: Affirmation form retained in Committee files.)

4/76

Exhibit 5
(page 1 of 6)

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Explanation of Any Restrictions on Financial Interests or Positions Held by Trustees of the Financial Accounting Foundation, Corporate Electors of the Foundation, or Members of the Financial Accounting Standards Advisory Council

The effect of the Foundation's By-Laws and the Trustees' Policies (see Exhibits 4 and 4.01) assures that Board Members are at all times free from outside pressures and influences which might give rise to a conflict of interests or the appearance of a conflict, or which might affect their integrity, independence or objectivity. Accordingly, and apart from practical considerations, it has not been necessary to impose any restrictions in the Foundation's Certificate of Incorporation or By-Laws or in the Board's Rules of Procedure on financial interests or positions held by the Foundation's Trustees or electors, or members of the Advisory Council, with respect to parties other than the Board itself.

The Foundation's By-Laws and the Trustees' Policies prohibit (i) any Trustee from serving simultaneously as a Board Member, Director or staff member of the FASB, or as a member of the Advisory Council, and (ii) any member of the Advisory Council from serving simultaneously as a Trustee of the Foundation, or a Board Member, Director or member of the FASB staff.* Similarly, no elector of the Foundation may at the same time be a Board Member, Director, or FASB staff member.

*A Board Member, Director or staff member could serve on the Advisory Council, but none have done so except the Board Chairman, who is ex officio Chairman of the Advisory Council under the Foundation's By-Laws.

Moreover, in the case of the Foundation's electors and Trustees, there can be no direct participation by them in the work of the Board or in its deliberations on Statements of Financial Accounting Standards, Interpretations or exposure drafts. Indeed, their rights and duties are essentially formal, and intentionally not substantive in terms of the Board's work.

Thus, under the Foundation's Certificate of Incorporation, electors of the Foundation (i.e., its members, or stockholders if it were a business corporation) are ex officio the Board of Directors of the AICPA. However, their rights and duties as electors are limited by the Certificate of Incorporation to solely the election and removal of the Foundation's Trustees.

Similarly, Article Sixth of the Foundation's Certificate of Incorporation provides that all authority, functions and powers of the Foundation and Trustees in respect of standards of financial accounting and reporting, including the conduct of all activities relating thereto, are delegated to the Standards Board. In furtherance of this, Section I of Chapter A, Article I-A of the Foundation's By-Laws provides that the Trustees may not, by or in connection with the exercise of approval of annual budgets, direct the FASB to undertake or to omit to undertake any particular project or activity, or otherwise affect the exercise by the FASB of its functions and powers in respect of standards of financial accounting and reporting. Apart from the Trustees' authority over the budget and to appoint

and remove members of the FASB* and FASAC, the Trustees' remaining authority is limited to periodic review of the Foundation's By-Laws and the basic structure for establishing standards of financial accounting and reporting. This "oversight function" is further limited by the requirement in both the Foundation's Certificate of Incorporation and By-Laws that structural changes affecting the Board and the Advisory Council can only be made on the affirmative vote of eight of the nine Trustees.

A principal finding of the 1972 Study Group was that establishing standards for financial accounting and reporting required continued extensive participation by the accounting profession, both in terms of support for and enforcement of pronouncements, as well as in the belief that members of a profession are likely to be independent in their judgments. The role of the Board of Directors of the AICPA as the Foundation's electors, and the fact that five of the Foundation's nine Trustees are independent accountants and a sixth is an accounting educator, implements this aspect of the Study Group report. This structure also recognizes the unique position and substantial duties imposed on the accounting profession by Congress in the Federal Securities Laws and through the Securities and Exchange Commission in its administration of those Laws.

As mentioned previously (see Exhibit 4), the 1972 Study Group also concluded that, in addition to independent accountants, the work of the Board would be benefitted by the participation of knowledgeable individuals and persons with complementary or other relevant

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*A Board member can be removed only by a vote of two-thirds of the Trustees, and then only by reason of disability, malfeasance or alleged malfeasance, or conduct otherwise detrimental to the Foundation or the FASB.

skills. The Board's Advisory Council provides this additional dimension in the words of the 1972 Study Group as the Board's "permanent instrument for maintaining contact with the business and professional world."

The only qualification for membership on the Advisory Council is the capacity and willingness of an individual to make a contribution to the work of the Board. Accordingly, Section I, Chapter A of Article III-A of the Foundation's By-Laws provides that membership on the Advisory Council is personal to the individuals appointed and no member may delegate his function as a Council member to others. Council members are appointed for terms of one year, and may be reappointed for additional terms. The Advisory Council has at least 20 members, which at any particular time may vary upwards as the needs of the Board change. The current Advisory Council has 32 members. (See Appendix E) Consistent with the personal nature of membership, the Advisory Council does not vote or otherwise act together as a body.

As the Advisory Council is the Board's formal liaison with the business and professional world, the Foundation's By-Laws provide that, upon request of the FASB's Chairman, members of the Advisory Council will consult with the Board concerning its agenda of projects and the assignment of priorities, the selection and organization of task forces, and such other matters as may be requested. The Board is required to submit proposed Interpretations to members of the Advisory Council for their individual comments at least fifteen days prior to final adoption by the Board, and members of the Advisory Council may also be asked to review other proposed pronouncements.

However, except for submitting proposed Interpretations for comment, there is no requirement that the Board consult with members of the Advisory Council.

It would be impossible to impose restrictions as to financial interests and positions held by members of the Advisory Council beyond those mentioned above and still attract individuals with that level of competence and diversity of expertise providing maximum support to the Board. This becomes apparent when one considers that among those serving on the Advisory Council at varying times during the last three years have been:

- independent public accountants
- accounting educators
- financial and accounting executives
- financial analysts
- the Comptroller General of the United States
- the former Chairman of the Board of Governors of the Federal Reserve System
- the Assistant Comptroller General of the United States
- former Commissioners of the SEC
- a director of the U. S. General Services Administration
- a former Chief Accountant of the SEC
- the Director of Bureau of Accounts of the Interstate Commerce Commission
- a former Chairman of the New York Stock Exchange

- the Chairman of the American Stock Exchange
- a member of the CASB
- the Chairman of New York's Municipal Assistance Corporation
- attorneys

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FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Professional Staff at May 15, 1976

Listed below is the professional staff of the FASB as at May 15, 1976. The present position of each person is shown, along with their respective affiliations immediately prior to joining the FASB staff. (See Appendix A)

Staff Directors:	Previous Affiliation
J. T. Ball, Director of Emerging Problems	AICPA - Research Associate for Accounting Interpretations
Michael A. Pinto, Director of Administration	AICPA - Special Assistant to the Executive Vice President
*George J. Staubus, Director of Research and Technical Activities	University of California - Professor of Business Administration
Paul A. Pacter, Deputy Director of Research and Technical Activities	**Hurdman & Cranstoun - Manager of Research & Special Projects
Project Directors:	
Jules M. Cassel	**Peat, Marwick, Mitchell & Co. - Manager, Department of Professional Practice
Dale L. Gerboth	AICPA - Project Manager - Research Division
Glendon R. Hildebrand	**Arthur Andersen & Co. - Audit Manager
Robert L. Koons	Shell Oil Co. - Manager of Accounting Research & Policy
Paul R. LePage, Jr.	**Arthur Young & Company - Principal, Consulting & Report Review Department

*Employment commences on or about July 1, 1976.
**Independent public accountants

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Project Directors (concluded):	Previous Affiliation
Norman E. Mattson	**Price Waterhouse & Co. - Audit Manager
William G. Shenkir	University of Virginia - Professor of Accounting

Technical Advisors:	
Edward J. McGowen	**Alexander Grant & Company - Partner
Reed K. Storey	Baruch College - Professor of Accounting

FASB Fellows (technical staff):	
Thomas F. Cox, Jr.	**Peat, Marwick, Mitchell & Co. - Audit Supervisor
Paul E. Gricus	**Arthur Young & Company - Audit Manager
Robert C. Steiner	**Haskins & Sells - Audit Manager
Bruce D. Sullivan	**Ernst & Ernst - Audit Manager
Cecilia V. Tierney	Washington State University - Associate Professor of Business Administration

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Research & Technical Associates:

Mimi Burke	**Laventhol & Horwath - Partner
Alf M. Eastergard	**Elmer Fox, Westheimer & Co. - Researcher and Reviewer
Paul Moverley	Ford Motor Company - Supervisor, Consolidations
Diana L. Winnett	Exxon Corp. - Financial Analyst

Technical Assistants:

Stephen C. Adams	Student
Paul R. Brown	**Arthur Andersen & Co. - Staff Accountant
Richard T. Grainger	**Arthur Andersen & Co. - Staff Accountant
George E. McClammy, Jr.	Student
Keith A. Shriver	Arizona State University - Graduate Assistant
Kenneth R. Youngson	Lone Star Industries, Inc. - Senior Accountant

Staff Administrators:	Previous Affiliation
Patricia M. Holborn, Project Administration	Pepsico, Inc. - Secretary to Director of Personnel
Stewart O. Manthey, Internal Operations	Union Pacific Corp. - Manager of Accounting and Reporting
Lourdes M. Mayer, Publications	AICPA - Administrative Assistant to Vice President, Education
Robert Van Riper, Public Information	N. W. Ayer & Son, Inc. - Senior Vice President and Director of Public Relations

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FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Consultants Engaged from January 1, 1973
(date of inception) to May 15, 1976

Listed below are the names of persons engaged as paid consultants to the Financial Accounting Foundation and Financial Accounting Standards Board from January 1, 1973 (date of inception) through May 15, 1976. This listing includes the affiliations of the consultants and the specific project to which they are or were assigned.

Name	Affiliation	Assignment
Horace Brock	North Texas State University	Chairman of the task force dealing with financial accounting and reporting in the extractive industries.
Joe J. Cramer	Pennsylvania State University	Technical writer on the discussion memorandum on accounting and reporting for employee benefit plans, and the exposure draft on financial reporting in units of general purchasing power.
Bruce Collier	Oklahoma State University	Technical writer on the discussion memorandum on accounting for research and development and similar costs.
Michael Crooch	Oklahoma State University	Technical writer on the discussion memorandum on accounting for research and development and similar costs.
Thomas Dyckman	Cornell University	Consult on the design and use of research and testing methods.
Ralph Moore	Retired, Liggett & Myers, Inc.	Financial consultant to the Financial Accounting Foundation.

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Name	Affiliation	Assignment
Stephen Stewart	Retired Principal, Coopers & Lybrand*	Technical consultant on accounting for the cost of pension plans.
Curtis Youngdahl	Retired Partner, Haskins & Sells*	Researcher and writer on the discussion memorandum on criteria for determining materiality.

In addition to the above, the FASB appoints knowledgeable persons to serve on task forces established to study the issues related to specific technical projects on the Board's agenda. Additionally, knowledgeable persons are appointed to serve on the FASB's Screening Committee on Emerging Problems. The names and business affiliations of persons who have served to date on FASB task forces are set forth in Exhibit 7.01. Task force members receive no compensation. Members of the Screening Committee, who also serve without compensation, are shown at Exhibit 7.02.

*Independent public accountants

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FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Persons Who Have Served on FASB Task Forces
From January 1, 1973 (date of inception) to May 15, 1976

Name	Affiliation at Time of Appointment to Task Force	Task Force
Paul M. Albert, Jr.	Morgan Stanley & Co. Incorporated	Interim Fin. Reporting
Martin V. Alonzo	AMAX, Inc.	Interest Costs Extractive Industries
M. L. Alper	International Telephone & Telegraph Corporation	Future Losses*
Loren Alter	Allstate Insurance Companies	Future Losses*
Peter L. Anker	Smith, Barney & Co.	Extractive Industries
Robert N. Anthony	Harvard University	Conceptual Framework
Hector R. Anton	Haskins & Sells	Debtors and Creditors
Kenneth S. Axelson	J.C. Penney Company, Inc.	Leases
William J. Badecker	Hurdman and Cranstoun	Segments
David A. Baker	Boston Company, Inc.	Leases
Andrew Barr	American Institute of CPAs	Materiality
Preston C. Bassett	Towers, Perrin, Forster & Crosby, Inc.	Employee Benefit Plans & Cost of Pension Plans
William H. Beaver	Stanford University	Materiality
Norton M. Bedford	University of Illinois at Urbana-Champaign	R&D and Similar Costs
George S. Bissell	Massachusetts Financial Services, Inc.	Materiality
Dean M. Bloyd	Tesoro Petroleum Corporation	Extractive Industries
John F. Bogaard	Consultant, formerly with the Internal Revenue Service	Bus. Combinations
Horace Brock	North Texas State University	Extractive Industries

* Title of project subsequently changed to Accounting for Contingencies

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Name	Affiliation at Time of Appointment to Task Force	Task Force
R. Gene Brown	Berkeley Bio-Engineering Co.	Materiality
ctor H. Brown	Standard Oil Company (Indiana)	Bus. Combinations Extractive Industries
Dudley E. Browne	Lockheed Aircraft	R&D and Similar Costs
George N. Buffington	National Assoc. of Real Estate Investment Trusts, Inc.	Debtors and Creditors
Carl B. Burger	Geo. S. Olive & Co.	Bus. Combinations
George R. Catlett	Arthur Andersen & Co.	Conceptual Framework
John S. Chalsty	Donaldson, Lufkin & Jenrette, Inc.	Extractive Industries
Edwin Clemens	Forest Oil Corporation	Extractive Industries
Wayland Coe	U.S. Department of Labor	Employee Benefit Plans
Harold Cohan	S. D. Leidesdorf & Co.	Debtors and Creditors
Gordon R. Corey	Commonwealth Edison Company	Future Losses*
Putnam L. Crafts, Jr.	Studebaker-Worthington, Inc.	Bus. Combinations
lan C. Crane	A.O. Smith Corporation	Interim Fin. Reporting
James H. Crowley	The Aetna Life & Casualty Co.	Future Losses*
Joseph Cummings	Peat, Marwick, Mitchell & Co.	Foreign Currency Translation
Bernard F. Curry	Morgan Guaranty Trust Co.	Employee Benefit Plans
Clement H. Darby	Builders Investment Group	Debtors and Creditors
Sidney Davidson	University of Chicago	Leases
Robert S. Davis	St. Paul Companies, Inc.	Materiality
Philip Defliese	Coopers & Lybrand	Conceptual Framework
John S. de Graffenried	Merrill Lynch, Pierce, Fenner & Smith Inc.	Debtors and Creditors
Gary L. Depolo	Transamerica Corporation	Interest Costs
Marvin Deupree	Arthur Andersen & Co.	Foreign Currency Translation
ernard R. Doyle	General Electric Company	Cost of Pension Plans

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Name	Affiliation at Time of Appointment to Task Force	Task Force
Alan W. Drew	Peabody Galion Corporation	Segments
›bert C. Drummond	Mobil Oil Corporation	Extractive Industries
Robert W. Ehrlich	American Telephone & Telegraph Corporation	Cost of Pension Plans
Robert G. Ellis	Motorola, Inc.	Cost of Pension Plans
Robert W. Farrell	Bache & Co., Inc.	R&D and Similar Costs
Robert E. Field	Price Waterhouse & Co.	Extractive Industries
Edward P. Fischer	Mobil Oil Corporation	Foreign Currency Translation
Frank Forester	Morgan Guaranty Trust Company of New York	Foreign Currency Translation
William C. Foster	New York University	Segments
Anthony Fox	Connecticut General Life Insurance Company	Debtors and Creditors
Tilford C. Gaines	Manufacturers Hanover Trust Co.	Materiality
Oscar S. Gellein	Haskins & Sells	R&D and Similar Costs
Martin S. Gerstel	Alza Corporation	R&D and Similar Costs
Robert B. Gilmore	DeGoyler & MacNaughton	Extractive Industries
J. Spencer Gould	Arthur Young & Company	Segments
John A. Grady	Interstate Commerce Commission	R&D and Similar Costs
Clyde H. Graves	Consultant, formerly with the American Mutual Insurance Alliance	Future Losses*
David O. Green	University of Chicago	Interim Fin. Reporting
F. William Gridley	Chrysler Corporation	R&D and Similar Costs
Ray J. Groves	Ernst & Ernst	Bus. Combinations
Harvey V. Guttry, Jr.	The Times Mirror Company	Bus. Combinations
Joseph W. Halliday	White & Case	Debtors and Creditors
A. Phillip Hanmer	The Dow Chemical Company	Future Losses*

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Name	Affiliation at Time of Appointment to Task Force	Task Force
John E. Hart	Coopers & Lybrand	Future Losses*
Donald J. Hayes	Arthur Young & Company	Interest Costs
Ernest L. Hicks	Arthur Young & Company	Cost of Pension Plans
Thomas L. Holton	Peat, Marwick, Mitchell & Co.	Materiality
A. Charles Howell	John Hancock Mutual Life Insurance Co.	Cost of Pension Plans
Stanley M. Hunt	General Mills, Inc.	Segments
John W. Ingraham	Citicorp	Conceptual Framework
Robert O. Isban	Manufacturers Hanover Trust Co.	Interest Costs Debtors and Creditors
Ernest C. Janson, Jr.	Coopers & Lybrand	Extractive Industries
Robert J. Joedicke	Kuhn, Loeb & Co.	Debtors and Creditors
Kenneth P. Johnson	Coopers & Lybrand	Bus. Combinations Interest Costs
Orace Johnson	Ohio State University	R&D and Similar Costs
Robert S. Kay	Touche Ross & Co.	Bus. Combinations Interest Costs
Paul J. Kelsey	The Pillsbury Company	Interim Fin. Reporting
Jack F. Kincannon	Sears, Roebuck and Co.	Interest Costs
Alfred M. King	American Appraisal Associates Incorporated	Conceptual Framework
Harold Q. Langenderfer	University of North Carolina	Bus. Combinations
Irving S. Lauterbach	Clarence Rainess & Co.	Future Losses*
Raymond C. Lauver	Price Waterhouse & Co.	R&D and Similar Costs Cost of Pension Plans
Robert E. Leech	A.M. Pullen & Company	R&D and Similar Costs
J. Spencer Letts, Esquire	Teledyne, Inc.	Bus. Combinations
Theodore R. Lilley	Financial Analysts Federation	Employee Benefit Plans Cost of Pension Plans

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Name	Affiliation at Time of Appointment to Task Force	Task Force
Peter C. Lincoln	United States Steel and Carnegie Pension Fund, Inc.	Debtors and Creditors
Leonard Lorensen	American Institute of CPAs	Foreign Currency Translation
Norman J. Luke	Pennzoil Company	Extractive Industries
Oral L. Luper	Exxon Company, U.S.A.	Conceptual Framework
W. Fletcher Lutz	Alexander Grant & Co.	Leases
Robert A. Malin	The First Boston Corporation	Bus. Combinations
John W. March	Arthur Andersen & Co.	R&D and Similar Costs
Edward R. Marshall	Honeywell, Inc.	Segments
William McChesney Martin	Retired	Foreign Currency Translation
Randal B. McDonald	Arthur Andersen & Co.	Extractive Industries
Robert K. Mautz	Ernst & Ernst	Conceptual Framework
Maurice H. Mayo	General Electric Company	Segments
Charles T. McGarraugh	Northwest Bancorporation	Materiality
Dan McGill	University of Pennsylvania	Employee Benefit Plans Cost of Pension Plans
C. Edward Midgley	Kidder Peabody & Co., Inc.	Leases
Eugene J. Minahan	Atlantic Richfield Company	Materiality
Francis Mlynarczyk, Jr.	Citibank	Interest Costs
Charles H. Montgomery	First National Bank of Chicago and First Chicago Corporation	Debtors and Creditors
Robert A. Morgan	Caterpillar Tractor Co.	R&D and Similar Costs Interim Fin. Reporting
T. Lincoln Morison, Jr.	First National Bank of Boston	R&D and Similar Costs
Everett L. Morris	Public Service Electric & Gas Co.	Interest Costs
Gerhard G. Mueller	University of Washington	Foreign Currency Translation

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Name	Affiliation at Time of Appointment to Task Force	Task Force
Robert B. Murray	Eastman Kodak Company	Segments
Robert D. Neary	Ernst & Ernst	Interim Fin. Reporting
James W. Needham	White, Weld & Co.	Conceptual Framework
Carl L. Nelson	Columbia University	Future Losses* Debtors and Creditors
Theodore J. Newton, Jr.	Blyth Eastman Dillon & Co., Inc.	Future Losses*
William B. Nicol	Meaden & Moore	Materiality
Edmund R. Noonan	Peat, Marwick, Mitchell & Co.	Leases Debtors and Creditors
William C. Norby	Duff, Anderson & Clark	Segments
Richard E. Nordquest	Harsco Corporation	Cost of Pension Plans
David Norr	First Manhattan Company	R&D and Similar Costs Extractive Industries
Robert A. Orban	NCR Corporation	Interest Costs
John W. Ostrem	Household Finance Corporation	Interest Costs
C. Reed Parker	Duff, Anderson & Clark	Bus. Combinations
Russell Parker	Federal Trade Commission	Segments
R. MacDonald Parkinson	Clarkson, Gordon & Co.	Foreign Currency Translation
Louis G. Peloubet	Textron, Inc.	Segments
Raymond E. Perry	Touche Ross & Co.	Cost of Pension Plans
William E. Pike	Morgan Guaranty Trust Co. of New York	Leases
Charles W. Plum	The Standard Oil Company (Ohio)	Segments
Richard M. Pollard	Touche Ross & Co.	Extractive Industries
Stanley P. Porter	Arthur Young & Company	Extractive Industries
Claude Poulin	UAW Social Security Department	Employee Benefit Plans
Henry A. Quinn	Peat, Marwick, Mitchell & Co.	Interim Fin. Reporting

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Name	Affiliation at Time of Appointment to Task Force	Task Force
Alfred Rappaport	Northwestern University	Segments
Donald G. Reed	Booz, Allen Acquisition Services, Inc.	Bus. Combinations
W. Rowland Reed	Continental Oil Company	Extractive Industries
Leonard G. Reichhard, Jr.	Union Service Corp.	Future Losses*
Robert Rennie	Touche Ross & Co.	Segments
Frank C. Roberts	Eaton Corporation	Segments
Robert B. Rothermel	Touche Ross & Co.	Interim Fin. Reporting
Frank E. Russell	Indianapolis Newspapers, Inc.	Materiality
Leonard Savoie	Clark Equipment Company	Interim Fin. Reporting
Edwin A. Schoenborn	Irving Trust Company	Interest Costs Debtors and Creditors
Charles W. Scott	Ernst & Ernst	Debtors and Creditors
Lee J. Seidler	New York University	Foreign Currency Translation
Gerald E. Sherrod	Citibank	Extractive Industries
Gordon Shillinglaw	Columbia University	Segments
Charles J. Simons	Eastern Airlines, Inc.	Debtors and Creditors
Bracy Smith	U.S. Steel Corporation	Interest Costs
Dan Throop Smith	Hoover Institution on War, Revolution & Peace	Foreign Currency Translation
George J. Staubus	University of California	Future Losses*
Joseph L. Stebick	Robertshaw Controls Company	R&D and Similar Costs
Walter P. Stern	Capital Research Company	Materiality
G. Frances Stone	Merrill Lynch, Pierce, Fenner & Smith Inc.	Foreign Currency Translation
Kenneth W. Stringer	Haskins & Sells	Materiality
F. Palmer Tang	Touche Ross & Co.	R&D and Similar Costs

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Name	Affiliation at Time of Appointment to Task Force	Task Force
Frank J. Tanzola	U.S. Industries, Inc.	Interim Fin. Reporting
Richard F. Tharp	Fireman's Fund Insurance Co.	Future Losses*
Robert C. Thompson	Shell Oil Company	Employee Benefit Plans Cost of Pension Plans
Carl Tietjen	Price Waterhouse & Co.	Conceptual Framework
Harry Van Benschoten	Newmont Mining Corporation	Extractive Industries
J.V. van Pelt III	Retired, Vulcan Materials Company	Future Losses*
Joseph Van Vleck III	Travelers Insurance Companies	Materiality
George Vogt	Peat, Marwick, Mitchell & Co.	Employee Benefit Plans Cost of Pension Plans
Brooks Walker, Jr.	United States Leasing International, Inc.	Leases
Richard Walker	Arthur Andersen & Co.	Interest Costs
Randolph H. Waterfield	Arthur Young & Company	Future Losses*
orge C. Watt	Price Waterhouse & Co.	Foreign Currency Translation & Leases
Allan Wear	Ford Motor Company	Foreign Currency Translation
Professor Glenn Welsch	University of Texas	Interest Costs
Francis M. Wheat	Gibson, Dunn & Crutcher	Materiality
Clifford H. Whitcomb	Prudential Insurance Company of America	Employee Benefit Plans
Gerald I. White	Sterling Grace & Company	Interim Fin. Reporting
Robert Whitman	American Electric Power Co., Inc.	Leases
John A. Willis	Union Carbide Corporation	Foreign Currency Translation
Arthur Wyatt	Arthur Andersen & Co.	Leases & Interim Fin. Reporting
James Zid	Ernst & Ernst	Employee Benefit Plans

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Name	Affiliation at Time of Appointment to Task Force	Task Force
Charles T. Zlatkovich	The University of Texas at Austin	Conceptual Framework
Charles L. Zody	Exxon Company U.S.A.	Interest Costs
Alvin Zuckerkorn	J. K. Lasser & Co.	Future Losses*

Exhibit 7.02

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Members of the FASB Screening Committee on Emerging Problems
as of May 15, 1976

Name	Affiliation
William H. Conkling, Jr.	Hurdman & Cranstoun
Robert S. Kay	Touche Ross & Co.
Professor Harold Q. Langenderfer	School of Business Administration, University of North Carolina
Raymond C. Lauver	Price Waterhouse & Co.
Robert A. Malin	The First Boston Corporation
Robert K. Mautz	Ernst & Ernst
Robert A. Morgan	Caterpillar Tractor Company
David Norr	First Manhattan Company
Frank J. Tanzola	U. S. Industries, Inc.
Fred L. Tepperman	Arthur Young & Company
Robert C. Thompson	Shell Oil Company
Charles A. Werner	Alexander Grant & Co.
Arthur R. Wyatt	Arthur Andersen & Co.

Donald J. Kirk	Financial Accounting Standards Board
Walter Schuetze	Financial Accounting Standards Board
J. T. Ball	Financial Accounting Standards Board

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FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

General Statement regarding the Financial Accounting Standards Board's Communications with Congress, the SEC, CASB, and Other Federal Agencies or Departments

Because of the public implications of its work, it is necessary for the Financial Accounting Standards Board to keep itself apprised of developments within the federal government which either directly or indirectly affect FASB activities. For the same reason, the Board considers it important to keep the appropriate committees of Congress and certain executive departments and federal regulatory agencies fully informed with regard to the FASB's mission and the progress of specific projects. Thus the primary objective of the FASB's relations with the federal government is to develop and maintain mutual awareness.

The Financial Accounting Standards Board concerns itself with federal legislation only when proposed legislation deals with the establishment of financial accounting and reporting standards. The Board has presented testimony to a Congressional committee on one matter and submitted written presentations to members of committees of Congress on two matters.

At the request of the Committee Chairman, testimony was presented March 9, 1976 to the Senate Committee on Interior and Insular Affairs regarding S.1864, "Energy Information Act." A copy of this testimony is shown as Exhibit 8.01.

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On July 11, 1975 a letter was sent to the members of the House Committee on Interstate and Foreign Commerce regarding H.R. 7014, "Energy Conservation and Oil Policy Act of 1975." A copy of this letter is shown as Exhibit 8.02.

On October 3, 1975 a letter was sent to the members of the Conference Committee on S.622, "Energy Conservation and Oil Policy Act of 1975." A copy of this letter is shown as Exhibit 8.03.

On October 9, 1975 the Trustees of the Financial Accounting Foundation sent a letter to the members of the Conference Committee on S.622, "Energy Conservation and Oil Policy Act of 1975." A copy of this letter is shown as Exhibit 8.04.

Other FASB correspondence with members of Congress generally falls into three categories:

- General introductory letters describing the FASB and its mission in furtherance of the "mutual awareness" objective mentioned above;
- Letters from members of Congress commenting on FASB technical projects, and the Board's responses thereto;
- Letters from members of Congress seeking information in order to respond to constituents' inquiries, and the Board's responses thereto.

An example of each of these three categories of correspondence is shown in Exhibits 8.05 through 8.07.

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Members of the FASB staff contact the staff of Senators and Representatives and the appropriate Congressional committees on occasion through correspondence, telephone conversations, and informal meetings to inform them about the Board's activities.

The work of the FASB also requires that members of the Board and its staff engage in exchanges of information and points of view on technical issues with various executive departments and regulatory agencies of the federal government.

Because of the similarity of interests, there is extensive interface with the Securities and Exchange Commission and the Cost Accounting Standards Board. The principal objectives again are mutual awareness of accounting problems and progress toward their resolution, and avoidance, where possible, of duplicative or conflicting effort. Contacts range from informal meetings of the Standards Board with the SEC Commissioners and members of the CASB, to written comments on proposals of a technical nature offered by the respective bodies. Informal meetings of individuals and telephone conversations are held as needed. An example of correspondence with the SEC is shown as Exhibit 8.08. An example of correspondence with the CASB is shown as Exhibit 8.09.

To a lesser extent, there also is an exchange of information with such regulatory agencies as the Civil Aeronautics Board and the Federal Communications Commission. Examples of correspondence with these bodies are shown as Exhibits 8.10 and 8.11.

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There also are exchanges of information and viewpoints with various executive departments, including the Department of the Treasury, Internal Revenue Service, and Department of Labor. Examples of correspondence with executive departments are shown as Exhibits 8.12 through 8.14.

A further exchange of information and points of view results from participation by officials of various departments and agencies of the federal government on FASB task forces and the Financial Accounting Standards Advisory Council. Among the current members of the Advisory Council are the Comptroller General of the United States and the Director of the Bureau of Accounts, Interstate Commerce Commission. (See Exhibit 7.01 and Appendix E.) The Chief Accountant of the Securities and Exchange Commission has been an invited guest of the Chairman, with the privilege of the floor, at each Advisory Council meeting.

The mailing list of persons in the federal government receiving all FASB publications is shown as Exhibit 8.15.

The FASB has not concerned itself with legislation at the state level or with rule-making by state regulatory agencies.

Financial Accounting Standards Board

HIGH RIDGE PARK STAMFORD CONNECTICUT 06905 203-329-8401

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TESTIMONY BEFORE THE
COMMITTEE ON INTERIOR AND INSULAR AFFAIRS
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MARCH 9, 1976

I am Marshall Armstrong, Chairman of the Financial Accounting Standards Board. With me today are two of my colleagues, Donald J. Kirk and Horace Brock. Mr. Kirk is one of the other six Members of the Financial Accounting Standards Board and has a special oversight responsibility for our project on Financial Accounting and Reporting in the Extractive Industries. Dr. Brock, who is a professor of accounting at North Texas State University, is very experienced in oil and gas accounting matters and has been engaged as a special full-time consultant to the Board for this project. He is serving as chairman of our extractive industries task force.

It is my purpose to provide you with a general overview of the Financial Accounting Standards Board and its mission. Following that brief presentation, Mr. Kirk will discuss the scope and some limitations of our project on reporting in the extractive industries. Also, he will briefly identify some of the major issues which may be included as part of the project.

Since the Standards Board is relatively new and its mission and operating procedures may not be familiar to all members of the Committee, I would like to take just a few moments to explain our objectives and our overall organization.

The general objective of our work is to establish or improve standards of financial accounting and reporting, for the guidance and education of the public, investors, creditors, preparers and suppliers of financial information, reporting entities and certified public accountants.

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The organization is comprised of a tripartite structure which includes three distinct groups: the Financial Accounting Foundation, the Financial Accounting Standards Board, and the Financial Accounting Standards Advisory Council.

- The Foundation is organized to operate as an independent body in the private sector. Its primary purpose is to advance the state of the art of financial accounting and reporting. Its purpose is achieved through the work of the Standards Board and the Advisory Council. The Board of Trustees of the Foundation consists of nine persons who serve on a part-time basis without compensation. The Trustees are selected from nominations by five organizations:

    - American Accounting Association
    - American Institute of Certified Public Accountants
    - Financial Analysts Federation
    - Financial Executives Institute
    - National Association of Accountants.

  The Trustees of the Foundation have three principal responsibilities: to appoint the Members of the Standards Board and the Advisory Council, to raise the necessary funds to cover the operating expenses of the two groups, and to exercise a structure overview. The Trustees have no authority to effect the exercise by the FASB of its functions and powers with respect to the establishment of financial accounting standards.

- The Financial Accounting Standards Board is comprised of seven full-time, compensated Members. Board Members are required to sever all connections with the firms or institutions they served prior to joining the FASB. The Standards Board is supported by a technical and administrative staff of approximately eighty people.

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- The Financial Accounting Standards Advisory Council is presently comprised of thirty-two persons, each of whom is knowledgeable about the problems and impact of financial reporting, and each of whom possesses an expertise of value to the FASB. Members of the Council serve without compensation and meet to consult with the Board at least four times during each year. The Chairman of the Financial Accounting Standards Board serves ex officio as Chairman of the Advisory Council.

In the packet which was made available to each member of the Committee today, you will find copies of our By-Laws, our Rules of Procedure, and our Annual Report for 1974. If you find it convenient to review this material, I believe it will assist you in understanding our organization and its objectives.

The Foundation was incorporated in 1972 and the Financial Accounting Standards Board was operating with a full complement of Members and a skeleton staff by mid-1973. As I previously mentioned, the Board's staff at present consists of about eighty technical and administrative specialists. To provide some sense of the scope of our activities over the past thirty-two months, I might tell you the Board:

- Has issued twelve Statements of Financial Accounting Standards;
- Has issued nine Interpretations;
- Has issued nine Discussion Memoranda;
- Has conducted eleven Public Hearings;
- Has issued sixteen Exposure Drafts for public comment; and,
- Has published and distributed in excess of 2.3 million copies of Standards, Interpretations, Discussion Memoranda, and Exposure Drafts.

We are presently negotiating for the translation of our Standards and Interpretations into Spanish. We plan to explore translation into Japanese, German, and French.

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Previously, I mentioned the Foundation's responsibility to raise funds to support the operations of the Standards Board. The Foundation is qualified as an exempt organization under Section 501(c)3 of the Internal Revenue Code. Since inception in 1972, the Trustees have raised contributions of approximately $11,800,000 including $4,100,000 received in 1975. Of this, about $6,000,000 has been received from the public accounting profession, $5,400,000 from industry, and almost $400,000 from all other sources.

Our operating budget for 1976 is about $4,400,000.

The standards promulgated by the Financial Accounting Standards Board are employed in the preparation of financial statements of all business enterprises. The authority of our standards comes principally from three sources. First, standards are devised by men of stature and experience and are designed to be conceptually sound and implementable. Secondly, the Code of Professional Ethics of the American Institute of Certified Public Accountants requires its membership of practicing independent auditors to assure themselves that financial statements upon which they express their opinions conform to generally accepted accounting principles. The Institute's Code provides that pronouncements of the FASB constitute generally accepted accounting principles. The third source of authority of FASB standards stems from Accounting Series Release No. 150, issued by the Securities and Exchange Commission in December 1973. That Release in substance says that the Commission will continue its policy of looking to the private sector for leadership in establishing and improving accounting principles, with the expectation that the conclusions of the FASB will promote the interests of investors.

A copy of that Release has been provided for the members of the Committee.

The most important aspect of the Board's operating procedures, and one that I want this Committee to understand is the "due process" which characterizes our procedures for resolving accounting dilemmas and promulgating accounting standards.

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The Standards Board is charged with a responsibility of importance to the economic well-being of the United States. It is essential that we be responsive to the views of all segments of the economic community -- and our Rules of Procedure have been carefully formulated to ensure that we receive the counsel of as many interested groups and individuals as wish to be heard. We must always be cognizant, however, that our primary responsibility is to serve the public interest. That is the standard against which the success of our work will ultimately be judged.

Because of our public responsibility, we are very much in the public eye. Our Rules of Procedure stipulate that developments of importance to the public must be disclosed on a timely basis -- and this includes reporting agenda topics and priorities and the progress of task forces, as well as conducting public hearings and circulating exposure drafts of proposed pronouncements for comment.

In resolving the unique accounting issues related to extractive industries, as is the case with all major projects of the Board, we are proceeding as follows:

- We have tentatively defined the scope of the project;
- We have appointed a task force consisting of eighteen individuals, knowledgeable about oil and gas, and mining operations;
- The task force, under the chairmanship of Dr. Brock, will assist the Board and staff in drafting a discussion memorandum which will be the basis for a public hearing. The discussion memorandum, a neutral document, will identify the accounting issues and alternative accounting solutions for consideration;
- The Standards Board will make the final decision as to the acceptability of the proposed discussion memorandum, will publish it for written comment, and will announce a public hearing date;
- Testimony at the public hearing, letters of comment and position papers submitted to the Board will be carefully considered by each Member of the Board and by its technical staff;

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- At this stage in the process, the seven Members of the Board will commence deliberation and debate of the technical issues to be resolved;

- When at least five of the seven Members of the Board are in agreement, an exposure draft will be prepared and distributed for further public comment. This document will expose the Board's tentative conclusions with respect to the accounting issues;

- At the conclusion of an appropriate time for public comment (probably no less than sixty days) the Board will carefully examine the comment letters and position papers received and will determine whether alterations need to be made in the proposed solutions to the issues;

- When at least five of the seven Members of the Board are in agreement, a final Statement of Financial Accounting Standards on the extractive industries will be finalized and published.

We have provided you with copies of the Discussion Memorandum, the Exposure Draft, and the final Statement prepared in connection with our project on Foreign Currency Translation. I believe these will be helpful in understanding how we proceed.

Presently, the Board has on its agenda fourteen significant and pervasive accounting projects. Included is the one in which your Committee has a particular interest -- Financial Accounting and Reporting in the Extractive Industries.

I would like now to ask Mr. Kirk to briefly discuss the scope of that project and identify for you some of the issues that we may deal with.

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Good afternoon, gentlemen, I am Donald J. Kirk, and I am a Member of the Financial Accounting Standards Board. I should like to provide you today with some background on the project, a description of the scope, a report on our progress to date, and a prognostication of what I believe you can expect from the Board in connection with this project.

In the mid-1960s our predecessor, the Accounting Principles Board, added financial reporting in the extractive industries to its agenda, and undertook a research study to evaluate accounting practices that were then employed. The Research Study was published in 1969, and a public hearing held in November of 1971, but no standard was ever issued by the Accounting Principles Board on this project. At the inception of the FASB in 1973, the problem was passed on to this Board.

In our early deliberations we concluded that many other problems that had not been resolved warranted priority over accounting and reporting in the extractive industries. Therefore, the Board decided not to place it on the agenda at that time.

However, late last year, when the House and Senate had the Energy Conservation and Oil Policy Act (P.L.94-163) under consideration, the problem took on a new urgency. The Act, as initially drafted, provided that GAO would prescribe standards for financial information to be collected from energy producing and distributing companies. In response to this proposal, the SEC and the FASB both wrote to members of the House Interstate and Foreign Commerce Committee, recommending the participation of the Financial Accounting Standards Board in this process. In addition, we wrote to the Conference Committee and have provided you with a copy of our letter to Chairman Staggers. The Conference Committee obviously recognized the leadership role that the FASB is taking in the establishment of accounting standards. The Public Law as enacted provides that the Securities and Exchange Commission shall take necessary steps to insure the development of accounting practices for producers of crude oil and natural gas. Pursuant to the Law, the Commission shall have the authority to prescribe rules, or could rely on standards developed by the Financial Accounting Standards Board for these purposes. The SEC's intention is to rely on the FASB and as a result in October of last year, the extractive industries project was placed on our agenda.

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The Board's first step was to define the scope of the project with the assistance of a task force. The task force includes financial executives from extractive companies. practicing certified public accountants with extractive industries experience, consulting geologists, bankers, and financial analysts, as well as Dr. Brock, who is chairman.

Public Law 94-163 requires the SEC to consult with the FEA, GAO, and FPC in fulfilling its responsibility of insuring the development of accounting standards. As a result, representatives of the SEC, the GAO, the FPC, and the FEA have participated in all task force activities, as have representatives of the staff of the Oversight and Investigations Subcommittee of the House Interstate and Foreign Commerce Committee and of the staff of Representative Moss.

The task force first met in January and assisted us in defining the scope of the project. The second meeting of the task force was held yesterday.

At the present time, companies and activities expected to be affected by any standards of financial accounting and reporting resulting from our project, differ somewhat from those to be affected by Section 503 of Public Law 94-163, and differ significantly from those that would be affected by the energy information requirements of Senate Bill 1864.

The accounting practices of Section 503 of Public Law 94-163 affect companies engaged in the production of crude oil or natural gas. The information requirements of Senate Bill 1864 affect all energy producing and all significant energy consuming companies. Energy consuming companies are not covered by Section 503 of Public Law 94-163 and the definition of energy producing companies in S.1864 includes companies and activities far beyond those covered by Public Law 94-163.

The project which the Financial Accounting Standards Board is undertaking will apply to a somewhat different group of companies. Our project includes oil and gas producing companies, as well as <u>all</u> other companies engaged in the extractive industries. Thus, our project will include mining companies, not encompassed by either Public Law 94-163 or Senate Bill 1864. However, there are clearly areas of overlapping interest; thus, it would be desirable to coordinate our efforts.

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It is our present intention that the FASB project will concentrate on accounting and reporting issues that are unique to the extractive industries. In this project, we are not attempting to resolve broad accounting questions that are common to many or all industries. The project will seek to establish financial accounting and reporting standards relating to the exploration for, and acquisition, development, and production of, wasting natural resources, such as petroleum and natural gas and other mineral deposits. It will encompass all activities related to those functions, but at this time we do not contemplate that it will include refining, processing, distribution or transmission.

We anticipate that the following will be among the basic issues to be addressed in connection with the project:

- The merits of full cost versus successful efforts accounting, and the extent to and circumstances under which one or the other might be appropriate;
- Other possible methods of accounting for exploration and development costs;
- Definition, measurement, and valuation of mineral reserves;
- Allocation of costs where two or more minerals are produced from the same property;
- Problems surrounding the special types of conveyances employed in the extractive industries;
- Questions surrounding useful financial disclosure;
- Consideration of whether historical cost basis financial data for reserves should be supplemented by, or replaced by other information.

With the information that we have distributed to you is a copy of a memorandum from the FASB project director to the members of the task force. This sets out in greater detail the scope of the project and the specific issues which we have under consideration at the present time. It is much more detailed than what I have presented here and should provide you with a better indication of how we see the scope at this time.

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Under Public Law 94-163, the Securities and Exchange Commission is charged with developing accounting practices for crude oil and natural gas producers, and is authorized to rely upon standards developed by the FASB. The practices must be developed within twenty-four months after enactment of the Law, or by December of 1977.

We are in the process of developing the discussion memorandum and anticipate that it will be issued, written comments will be received, and public hearings held before the end of this year. This should place our project well within the time constraints of Public Law 94-163.

We expect that the project will resolve the financial accounting problems relating to the activities enumerated in Section 503 of Public Law 94-163 -- prospecting, acquisition, exploration, development and production.

At present, it does not appear that the FASB standard resulting from the project will satisfy those parts of Section 503 that call for the following:

- The separate calculation of capital, revenue, and operating cost information pertaining to -- prospecting, acquisition, exploration, development and production;

- Classification of financial information by function to facilitate correlation with reserves and operating statistics, both domestic and foreign.

These requirements go beyond those of financial reporting to shareholders.

We will, of course, maintain close liaison with the SEC during this project to insure that the FASB does all that it can to assist the SEC in accomplishing the legislative intent.

I believe as a summarization of the scope and limitations of our project it is appropriate to quote from our letter dated October 3, 1975 to Congressman Staggers:

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"The thrust of the project will be to establish financial accounting and reporting standards covering the exploration for, and the acquisition, development and production of petroleum and natural gas reserves. Its primary focus will be to resolve those major accounting issues on which present practice is divergent and on which, for years, opinion has been sharply divided within both the industry and the accounting profession. The project will also determine what information concerning these activities should be disclosed in financial statements and the accompanying notes and supporting schedules. Even though the project will not be directed toward the gathering and reporting of statistical and operating data over and above that which would appropriately be included in financial reporting, the establishment of uniform accounting standards will ensure comparability and enhance understanding of statistical type data derived from the accounting process."

With regard to S.1864, we also believe that our project will enhance the usefulness of accounting data of companies affected by our standard. In fact, all standards issued by the FASB enhance the usefulness of accounting data, because they result in increased consistency in the application of accounting principles.

Marshall Armstrong would like to offer some specific comments on S.1864.

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With regard to S.1864, it would, I believe, serve the public interests if the efforts of the Administrator to be appointed under the Bill, were coordinated with those of the Securities and Exchange Commission under P.L.94-163, to minimize the differences in accounting standards and to reduce the cost and effort needed to provide the desired data base. I suggest that the Committee consider relying upon standards devised pursuant to Public Law 94-163, to the extent that they are relevant, and upon any other standards for which the FASB is responsible.

This proposal would, I believe, further the objectives of a National Energy Information System and could avoid some of the additional cost and effort in the collection of the data base that would result from an independently developed accounting system. If further study of the Bill results in additional suggestions, we will inform you in writing.

This concludes the statement which we have prepared regarding the background and operations of the Financial Accounting Standards Board and our work to date on our extractive industries project. Mr. Kirk and I would be pleased to answer any questions which may have arisen as a consequence of this testimony and to provide you with any information which you feel might be helpful in connection with your deliberations. And, we are grateful for this opportunity to appear before you.

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MATERIALS TO BE DISTRIBUTED
PRIOR TO TESTIMONY BEFORE THE
SENATE COMMITTEE ON INTERIOR AND INSULAR AFFAIRS

- Certificate and By-Laws of the Financial Accounting Foundation
- Rules of Procedure of the Financial Accounting Standards Board
- 1974 Annual Report of the Financial Accounting Foundation
- SEC Accounting Series Release No. 150
- Documents relating to FASB project on Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements
- Letter to The Honorable Harley O. Staggers from Marshall S. Armstrong, dated October 3, 1975
- Task Force on Financial Accounting and Reporting in the Extractive Industries
- Memorandum to the Extractive Industries Task Force, dated February 27, 1976.

Financial Accounting Standards Board
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MARSHALL S. ARMSTRONG, Chairman of the Board

July 11, 1975

The Honorable Harley O. Staggers
Chairman, Interstate and Foreign
Commerce Committee
U.S. House of Representatives
2125 Rayburn House Office Building
Washington, D. C. 20515

Dear Chairman Staggers:

The members of the Financial Accounting Standards Board have read with interest Title VIII, "Energy Data Base," of H.R. 7014, a bill entitled the "Energy Conservation and Oil Policy Act of 1975." It is our understanding that Title VIII was added to H.R. 7014 during final deliberations by the House Interstate and Foreign Commerce Committee. Thus, it was not among the issues addressed during the public hearing held on H.R. 7014, and for that reason we offer these comments at this time.

Among other things, Title VIII requires that persons "engaged in the business of exploring, producing, transporting, refining, or distributing petroleum products shall use the uniform accounting practices prescribed under this subsection [by the General Accounting Office, subject to Congressional review] for purposes of reporting energy information or submitting any other matter to the office [OPAA] under subsection (b)." We believe that the present wording, as appears above and elsewhere in Title VIII, could result in confusion as to the intended scope of such GAO prescribed standards.

While we have a number of questions regarding the scope of some of the requirements imposed by Title VIII, the purpose of this letter is to urge that Title VIII be modified to state explicitly that the uniform accounting standards to

be promulgated by the General Accounting Office pursuant to Section 801(c) of that Title, would not be required for purposes of financial accounting and reporting by oil and gas companies to investors, creditors, and other financial statement users. Such modification, which is essentially a clarification, to Title VIII would not, in our judgment, affect the collection, compilation, and submission of supplemental energy-related data that may be desired for use in the formulation of national energy priorities and to meet the specific policy objectives of H.R. 7014. Moreover, this modification would have two significant and positive results.

> First, it would preserve, as we believe was intended, the statutory authority of the Securities and Exchange Commission under the Federal Securities Laws to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements filed with the Commission.

> Second, it would preserve the continuing relationship between the SEC and the private-sector standard-setting bodies (since 1973, the FASB) that has contributed greatly to progress in financial accounting and reporting and capital formation over the past 40 years.

The information needs of those in the Federal Government who are responsible for formulating and implementing national policy may not always be the same as the information needs of those who make the substantial capital commitments required by American industry. In some cases, Federal Government policymakers may require data prepared on bases different from or supplemental to those required by investors and other suppliers of capital. For example, the investor in a petroleum company might typically be concerned with the return on his investment, dividends, and the market value of the petroleum company security in which he has invested. The concerns of the Federal Government, on the other hand, may have a different orientation and may focus on, among other things, the overall oil and gas reserves of the nation and the need to strike a balance between the demand for and supply of this scarce resource.

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When the data requirements of the Federal Government and financial statement users are common, we believe that the uniform accounting standards objective of Title VIII should be accomplished by relying on the standards developed for financial accounting and reporting purposes when such standards exist. Such reliance would eliminate confusion and duplication of effort, thereby affecting cost economies both for the Federal Government and for those required to report under H.R. 7014.

As background for this recommendation, we have outlined briefly in an Appendix to this letter the historical development of financial accounting and reporting standards, the authority and responsibilities of the FASB in that process, and the Standards Board's work to date.

As indicated in that Appendix, the FASB is making and will continue to make substantial progress in developing standards of financial accounting and reporting. The Board's effort is directed toward establishing new standards, dealing with current reporting problems as they emerge, and toward developing a framework of fundamental concepts and principles upon which consistent application of accounting standards can be based.

Financial accounting and reporting standards do not usually affect just a single industry. Rather, they are more pervasive and tend to touch many different and widely diversified industries. For example, the FASB's Statement No. 5 on Accounting for Contingencies applies to oil and gas companies, as well as enterprises in the aerospace, automotive, pharmaceutical, insurance, and many other industries. It can be assumed that many of the Board's pronouncements will apply to companies in the oil and gas industry.

In some cases, though, certain activities of an industry are so peculiar to that industry that specialized financial accounting and reporting standards are desirable. A good example is the oil and gas industry.

One of the major unresolved questions of accounting in the oil and gas industry concerns the treatment of costs associated with unsuccessful exploration. Basically, the question is whether these costs should be considered to be an element of the overall costs of successful exploration (and capitalization), or whether such costs should be charged against income immediately.

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The FASB does not now have this question - described generally as full-cost versus successful-effort accounting - on its technical agenda. However, it is one of the topics that will be considered for inclusion on our agenda once work on other projects permits us to undertake study of new issues. In this regard, it should be recognized that certain of the information required by H.R. 7014 goes well beyond the traditional scope of financial accounting and reporting.

Copies of a booklet discussing accounting by the oil and gas industry are being provided to staff of the Interstate and Foreign Commerce Committee.

If you so desire, we would be pleased to elaborate further on the modification to Title VIII as proposed in this letter.

Sincerely,

Marshall S. Armstrong

Marshall S. Armstrong

MSA/mc
Enclosure

cc: Members of the Interstate and Foreign Commerce Committee
w/enclosure - ASR 150

Staff of the Interstate and Foreign Commerce Committee:
Mr. W. E. Williamson, Chief Clerk
Mr. Lewis E. Berry, Minority Counsel
w/enclosures - ASR 150
- Accounting and Reporting Practices in the Oil and Gas Industry

Staff of the Subcommittee on Oversight and Investigations of the Interstate and Foreign Commerce Committee:
Mr. Michael R. Lemov, Chief Counsel
Ms. Carolyn Emigh, Special Assistant
w/enclosures - ASR 150
- Accounting and Reporting Practices in the Oil and Gas Industry

The Honorable Ray Garrett, Jr.
Chairman, Securities and Exchange Commission
w/enclosure - ASR 150

The Honorable Elmer B. Staats
Comptroller General of the United States
w/enclosure - ASR 150

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MARSHALL S. ARMSTRONG, Chairman of the Board

October 3, 1975

The Honorable Harley O. Staggers
U.S. House of Representatives
2366 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Staggers:

This letter, addressed to you as a member of the Conference Committee on S.622 (Energy Conservation and Oil Policy Act of 1975), expresses the serious concerns of the Financial Accounting Standards Board regarding Title IX of the House-passed version of S.622, and suggests modifications intended to facilitate achievement of certain of the objectives of Section 903(a) in a more efficient and cost effective way.

Before addressing those concerns, however, the Board wishes to inform you of its decision this week to place on its technical agenda a major project on oil and gas accounting.

The thrust of the project will be to establish financial accounting and reporting standards covering the exploration for, and the acquisition, development and production of petroleum and natural gas reserves. Its primary focus will be to resolve those major accounting issues on which present practice is divergent and on which, for years, opinion has been sharply divided within both the industry and the accounting profession. The project will also determine what information concerning these activities should be disclosed in financial statements and the accompanying notes and supporting schedules. Even though the project will not be directed toward the gathering and reporting of statistical and operating data over and above that which would appropriately be included in financial reporting, the establishment of uniform accounting standards will ensure comparability and enhance understanding of statistical type data derived from the accounting process.

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As you may know, the Financial Accounting Standards Board is the independent, full-time body in the private sector with responsibility for establishing financial accounting and reporting standards. The Securities and Exchange Commission, in Accounting Series Release 150, formally endorsed the FASB as the organization in the private sector to provide leadership in establishing accounting standards and stated that, "... principles, standards and practices promulgated by the FASB...will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered to have no such support." Copies of ASR 150 and our Rules of Procedure are enclosed for your information.

Our recommended changes to Section 903(a) of Title IX are intended to eliminate what we perceive to be an unnecessary, time-consuming, and costly duplication of effort. Further, our recommendations, if adopted, would preserve the continuing and constructive relationship that exists between the Securities and Exchange Commission and the Financial Accounting Standards Board.

Section 903(a) of Title IX provides, in part:

> "For purposes of developing a reliable energy data base related to the production of crude oil and natural gas, the Securities and Exchange Commission shall, by rule, after consultation with the Financial Accounting Standards Board, prescribe accounting practices to be followed in the preparation of accounts by persons engaged, in whole or in part, in the production of crude oil or natural gas in the United States. Such rules shall be prescribed not later than twenty-one months after the date of enactment of this Act...."

Our concern focuses on the requirement that the SEC prescribe accounting practices "by rule," and that such practices be prescribed within twenty-one months after enactment of the legislation.

Apparently the intent of requiring rule-making by the SEC is to ensure that proposed rules will be exposed for public comment prior to final adoption. This point was articulated by Congressman John Moss, sponsor of the amendment

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of which Section 903(a) is part, during House debate on H.R. 7014. In response to a question, Mr. Moss said:

> "In this amendment [the SEC] would be required to act by rule in order to afford a hearing on proposed accounting standards, because if they were to act merely by recognition or acceptance of the standards, there would be no opportunity for a hearing. Therefore, this is a preservation of the right to be heard before the standard is adopted."

Certainly such intent is in the public interest in view of the complexity of the issues to be dealt with. However, in our judgment, the practical effect of the rule-making requirement would be an unwarranted and costly duplication of effort and an unnecessary delay in implementing proposed standards. This would be so since the FASB's Rules of Procedure require adherence to a broad program of public participation in the standard-setting process; in many respects our requirements extend beyond those of the Federal Administrative Procedure Act.

Our Rules of Procedure require that all proposed standards be issued for comment to interested parties. Typically, and particularly with respect to complex issues such as oil and gas accounting, concerned parties are given fifty days or more for commenting on a proposed standard. On these major projects, our process begins generally with the appointment of a task force of knowledgeable persons from government, industry, public accounting and other relevant disciplines to advise and assist the Board in defining the issues and alternative solutions. The work of the task force and our staff culminates in publication of a Discussion Memorandum (a research study) which serves as the basis for a public hearing and submission of written comments. Only after the public hearing does the Board commence its deliberations on the issues, a process which results in the issuance of a draft standard for additional public comment. It should be noted that in excess of thirty thousand copies of our proposed standards are sent to interested parties. Their comments are encouraged -- and given careful attention.

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Thus, the need for "due process" in the resolution of complex and far-reaching accounting issues is fully satisfied by the FASB's own procedures. To superimpose a second "exposure" requirement on top of the process followed by the Standards Board would appear to be counter-productive, particularly when you consider that the same basic audience would be asked to comment twice on the same proposed standard.

The second major concern we have with the requirement that the SEC prescribe accounting practices "by rule" is that it would seriously disrupt the productive and cooperative relationship between public and private sectors that has existed for more than four decades, and which has contributed greatly to progress in financial accounting and reporting standards and capital formation. If the SEC rule-making procedure were to be imposed on top of our due process, the FASB's effectiveness as the standard-setting body would be significantly challenged.

Our concerns regarding that specification in Section 903(a) are shared by the Securities and Exchange Commission. In his letter of August 22, 1975 to Mr. Frank G. Zarb, Administrator of the Federal Energy Administration, SEC Chairman Ray Garrett, Jr. expressed the views of the Commission this way:

> "We believe strongly that the current standard-setting apparatus [the FASB] is a good one and should not be upset. Because the FASB is a recently created organization [1973], care must be taken that its credibility is not eroded. We believe that a statutorily required governmental rulemaking procedure at this time to establish accounting standards by rule would seriously impair the effectiveness of the Board."

We are concerned also about the requirement in Section 903(a) that accounting rules for oil and gas producing companies be prescribed within twenty-one months after enactment of the legislation. Our experience and that of our predecessor bodies indicates that the resolution of highly complex accounting issues, particularly one as complex as the oil and gas accounting project, requires a longer period of time. The need to conduct research into the problem area, to accumulate and analyze data

Exhibit 8.03
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received from public respondents regarding the subject, and to evaluate the merits and the impact of alternative solutions is time consuming -- all of which is very essential, however, if the ultimate standard is to be theoretically sound and capable of implementation.

As you can appreciate, this essential due process, fact finding, and data collection can in many cases require more than twenty-one months for resolution of the problem.

For these reasons we concur with the statement made by Chairman Garrett in his letter to Mr. Zarb:

> "We would have no objection to being directed by the Congress to assure that uniform accounting standards are developed for the petroleum industry within a reasonable period of time and to report to the Congress on the accomplishment of this objective at a particular date. We believe that a period of time of at least 36 months will be required for this task."

Specifically, we recommend that Section 903(a), Title IX of the House-passed version of S.622 be modified as follows:

1. Delete: ". . . the Securities and Exchange Commission shall, by rule, after consultation with the Financial Accounting Standards Board, prescribe accounting practices to be followed . . ."

   Insert: ". . . the Securities and Exchange Commission, following the policy articulated in its Accounting Series Release 150, shall ensure that accounting standards are promulgated within a reasonable period of time, such accounting standards to be applied . . ."

2. Delete: "Such rules shall be prescribed not later than twenty-one months after the date of enactment . . ."

   Insert: "The Securities and Exchange Commission shall report to the Congress on progress toward establishment of such standards not later than eighteen months after the date of enactment

Exhibit 8.03
(page 6 of 7)

of this Act and shall exercise its statutory authority to ensure that such standards are in effect not later than thirty-six months after the date of enactment . . ."

Finally, it should be recognized that the resolution of most, if not all, of the sixteen technical projects currently under active study by the FASB, will affect financial accounting and reporting by oil and gas producing companies. In addition to the major oil and gas project just added to our agenda, some of the major projects on which we are working presently include:

- Accounting for Income Taxes - Oil and Gas Producing Companies
- Financial Reporting for Segments of a Business Enterprise
- Translation of Foreign Currency Transactions and Foreign Currency Financial Statements
- Financial Reporting in Units of General Purchasing Power
- Accounting for Interest Costs
- Business Combinations and Purchased Intangibles
- Accounting for Leases
- Conceptual Framework for Accounting and Reporting

We appreciate the opportunity to comment on Section 913(a) of Title IX and would be pleased to elaborate further on the views and opinions expressed in this letter.

Sincerely,

Marshall S. Armstrong

Marshall S. Armstrong

Enclosures: SEC Accounting Series Release 150
FASB Rules of Procedure

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(page 7 of 7)

Copies of This Letter Sent to:

- Members of the Conference Committee on S.622 and their Administrative Assistants:

The Honorable Harley O. Staggers - Marguerite Fufari
The Honorable Torbert H. Macdonald - Peter Knight
The Honorable John E. Moss - Kathleen Benson
The Honorable John D. Dingell - Mary Wood
The Honorable Paul G. Rogers - Richard Lepeska
The Honorable James T. Broyhill - Betty Conley
The Honorable Clarence J. Brown - James McIntire
The Honorable Henry M. Jackson - Sterling Monroe
The Honorable J. Bennett Johnston - Charles W. McBride
The Honorable James Abourezk - Peter Stavrianos
The Honorable Floyd K. Haskell - Dayton Olson
The Honorable John Glenn - William White
The Honorable Richard Stone - Eli Feinberg
The Honorable Dale Bumpers - Archibald R. Schaffer
The Honorable Warren G. Magnuson - Norman Dicks
The Honorable Ernest F. Hollings - Michael J. Copps
The Honorable John O. Pastore - James A. McKenna
The Honorable Vance Hartke - Lynn Mack
The Honorable Philip Hart - Sidney H. Woolner
The Honorable Howard Cannon - Aubrey Sarvis
The Honorable Adlai E. Stevenson - Thomas Wagner
The Honorable Paul Fannin - Joseph S. Jenckes
The Honorable Clifford Hansen - Paul Holtz
The Honorable James McClure - Richard K. Thompson
The Honorable Dewey Bartlett - Don Cogman
The Honorable Ted Stevens - George Nethercutt
The Honorable Robert P. Griffin - Cecil Holland
The Honorable J. Glenn Beall, Jr. - Dennis Thomas
The Honorable Lowell Weicker, Jr. - Bob Herrema

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FINANCIAL
ACCOUNTING
FOUNDATION
HIGH RIDGE PARK, STAMFORD, CONNECTICUT 06905 (203) 329-8401

October 9, 1975

(This letter was sent to members of the Conference Committee on S.622.)

The Honorable

At the direction of the Trustees of the Financial Accounting Foundation, I am writing to you, in your capacity as a member of the Conference Committee on S.622 (Energy Conservation and Oil Policy Act of 1975), with respect to Title IX of the House version of S.622.

The Financial Accounting Foundation is an independent non-profit organization in the private sector whose sole purpose is to establish and improve financial accounting and reporting standards through the work of the Foundation's independent appointive body, the Financial Accounting Standards Board (the "FASB").

The Trustees of the Financial Accounting Foundation have considered Title IX as published in the Congressional Record of September 23, 1975. We are aware of the positions expressed in opposition to Title IX and its predecessor versions by the Comptroller General of the United States, the Securities and Exchange Commission, the American Institute of Certified Public Accountants, the Financial Executives Institute, and the Financial Accounting Standards Board, among others. The Financial Accounting Foundation also opposes adoption of Title IX of S.622 in its present form. We believe that the objective of establishing accounting standards can best be accomplished by a coordination of the efforts of the SEC and the FASB. Consequently, we support, without qualification, the views expressed to you by Marshall S. Armstrong, Chairman of the FASB, in his letter of October 3, 1975. We urge that Section 903(a) of Title IX be modified as recommended in Mr. Armstrong's letter.

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The Foundation is strongly of the view that the reliability and credibility of financial statements, and the establishment and improvement of financial accounting and reporting standards, will most effectively, efficiently and economically result if the historical cooperation between the public and private sectors continues as it has since Congress' passage of the Securities Exchange Act of 1934.

The Securities and Exchange Commission, without abdicating its statutory authority under the 1934 Act, has long looked to the authoritative accounting standards setting bodies in the private sector for leadership in establishing and improving financial accounting and reporting. Legislation which would change this historical relationship by directing the Commission to prescribe by rule accounting practices for the petroleum industry will, in our judgment, result in erosion of confidence in the role of the private sector in establishing accounting standards, raise further doubts and confusion in the minds of investors as to the petroleum industry, and prove disruptive to the national securities markets. These risks are most serious, for public confidence is critical if the huge capital commitments required, in the national interest, by the petroleum industry are to be raised in the public markets. We firmly believe that the legitimate aims of Congress and the Federal Government can be realized on a timely basis, without assuming these risks and jeopardizing the existing framework which has proved successful for over 40 years in establishing and improving accounting principles and standards.

In order to provide background for our concerns with Section 903(a) of Title IX, I believe a brief summary of the purpose of the Financial Accounting Foundation, and its responsibility over the basic structure of establishing and improving standards of financial accounting and reporting through the Financial Accounting Standards Board, may be helpful. In this regard, I enclose the Foundation's 1974 Annual Report for your information.

Since the enactment of the Securities Exchange Act of 1934, the Securities and Exchange Commission has been empowered by Congress to prescribe financial reporting practices to be followed by publicly held enterprises. In meeting these statutory obligations, the Commission has recognized the expertise, energy and resources of the accounting profession and industry and, without abdicating its statutory responsibilities, has historically looked to the private sector's standard setting bodies to provide leadership in establishing and improving accounting principles. This relationship was most recently described as a statement of policy in the Commission's Accounting Series Release No. 150 in December 1973. A copy of this Release accompanied Chairman Armstrong's letter of October 3.

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(page 3 of 6)

During the over 40-year history of the private sector's commitment to establishing and improving accounting and reporting standards, much has been done to narrow areas of difference in practice. From 1939 until 1973, the Committee on Accounting Procedure and the Accounting Principles Board of the American Institute of Certified Public Accountants were the designated bodies in the private sector for this purpose. During this period 51 Accounting Research Bulletins and 31 Accounting Principles Board Opinions were issued.

In March 1971 the AICPA appointed a study group - the Wheat Committee (whose chairman was a former SEC Commissioner) - to make a comprehensive study on the establishment of accounting principles. The Wheat Committee's report of March 1972 contained recommendations for further improving the establishment of accounting principles. Two important recommendations were (i) the direct involvement of industry and the business community, financial analysts, and academe, as well as the accounting profession, in the establishment of accounting principles, and (ii) the creation of the Financial Accounting Foundation, as a body independent from the AICPA, to assume the responsibility for the creation and funding of the Financial Accounting Standards Board as an independent, full-time body within the private sector for establishing and improving financial accounting and reporting standards. These recommendations received the endorsement of the Securities and Exchange Commission.

In July 1973 the Financial Accounting Standards Board succeeded the AICPA's Accounting Principles Board as the authoritative standards setting body in the private sector. The Code of Professional Ethics of the AICPA requires adherence by the accounting profession to the Statements and Interpretations issued by the Financial Accounting Standards Board. The Securities and Exchange Commission, in its Accounting Series Release No. 150, formally endorsed the Financial Accounting Standards Board and indicated that it intended to continue its policy of looking to the private sector for leadership through the FASB. In commenting on the predecessor of Title IX, Chairman Garrett of the SEC stated that the Commission believes strongly that the current standards setting apparatus is a good one and should not be upset. The Commission has also expressed confidence that adequate practices in the oil and gas area can be achieved by the Financial Accounting Standards Board with the cooperation of the Commission, consistent with the Commission's policy of supporting the FASB as set forth in Accounting Series Release No. 150.

In addition to the seven full-time Board members, on September 30, 1975, the FASB had approximately 75 additional employees performing professional and technical, administrative and support functions. In 1974 the FASB's budget was $3,400,000 and its 1975 and 1976 budgets are expected to be $3,600,000 and $3,900,000, respectively. These funds come from contributions solicited annually from industry, the financial community, the accounting profession, academe and the public at large. The Financial Accounting Foundation is directly concerned with funding the work of the FASB on as broad a base of public participation as possible. This support is more than financial, for an

Exhibit 8.04
(page 4 of 6)

important aspect of the FASB framework is the Financial Accounting Standards Advisory Council, a body of 32 knowledgeable and experienced persons, established to assist the FASB in choosing and assigning priorities to agenda topics, commenting on proposed FASB Statements and Interpretations, and providing such other advice and assistance as is requested. The Advisory Council has several members with long years of service in Government agencies, including:

Elmer B. Staats, Comptroller General of the United States
John A. Grady, Director of Bureau of Accounts, Interstate Commerce Commission
Andrew Barr, former Chief Accountant, Securities and Exchange Commission
Francis M. Wheat, former Commissioner, Securities and Exchange Commission

In addition, John C. Burton, Chief Accountant of the Securities and Exchange Commission, is invited and attends meetings of the Advisory Council. It should also be noted that Arthur Litke, former Chief, Office of Accounting and Finance, Federal Power Commission, is one of the 7 full-time members of the FASB.

To date the FASB has issued seven Statements of Financial Accounting Standards, six Interpretations of existing accounting standards and has either exposed proposed Statements for public comment or has under active consideration at various stages of completion approximately ten other accounting and reporting issues. Many of the subjects on which the Financial Accounting Standards Board has spoken, as well as those in various stages of consideration, will affect financial accounting and reporting by petroleum companies. Of particular significance, and as Chairman Armstrong advised in his letter, the FASB has formally added to its technical agenda a major project aimed at establishing financial accounting and reporting standards covering the exploration for, and the acquisition, development and production of, petroleum and natural gas reserves.

The general acceptance of the FASB as the authoritative standards setting body has been demonstrated, and we firmly believe that standards of financial accounting and reporting can best be established within the framework which has existed so successfully since 1934. Accordingly, we again strongly urge that Section 903(a) of Title IX be modified as recommended in Chairman Armstrong's letter of October 3.

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(page 5 of 6)

The Trustees of the Financial Accounting Foundation would be pleased to discuss our views and concerns further with you should you wish.

Sincerely yours,

FINANCIAL ACCOUNTING FOUNDATION

By /s/ John C. Biegler
John C. Biegler, Trustee

Enclosure

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(page 6 of 6)

Conference Committee on S. 622, The Energy Conservation and Oil Policy Act of 1975

Senate Conferees

Henry Jackson (D-Wash).	223-3441	Sen. Interior and Insular Affairs
Bennett Johnston (D-LA.)	224-5824	Sen. Interior and Insular Affairs
James Abourezk (D-S.D.)	224-5824	Sen. Interior and Insular Affairs
Floyd Haskell (D-Colo.)	224-5941	Sen. Interior and Insular Affairs
John Glenn (D-Ohio)	224-3353	Sen. Interior and Insular Affairs
Richard Stone (D-FL.)	224-3041	Sen. Interior and Insular Affairs
Dale Bumpers (D-Ark)	224-4843	Sen. Interior and Insular Affairs
Paul Fannin (R-Ariz)	224-4521	Sen. Interior and Insular Affairs
Clifford Hansen (R-Wyo)	224-5842	Sen. Interior and Insular Affairs
James McClure (R-Idaho)	224-2752	Sen. Interior and Insular Affairs
Dewey Bartlett (R-Okla)	224-4721	Sen. Interior and Insular Affairs
Warren Magnuson (D-Wash)	224-2621	Sen. Commerce
Ernest Hollings (D-SC)	224-6121	Sen. Commerce
Adlai Stevenson (D-Ill)	224-2854	Sen. Commerce
John Pastore (D-RI)	224-2921	Sen. Commerce
Vance Hartke (D-Ind)	224-4814	Sen. Commerce
Howard Cannon (D-Nev)	224-6244	Sen. Commerce
Robert Griffin (R-Mich)	224-6211	Sen. Commerce
Ted Stevens (R-Alaska)	224-3004	Sen. Commerce
Glenn Beall (R-Maryland)	224-4524	Sen. Commerce
LowellWeicker (R-Conn)	224-4041	Sen. Commerce
Howard Baker (R-Tenn)	225-4944	Sen. Public Works
Edmund Muskie (D-Maine)	225-5344	Sen. Public Works
Jennings Randolph (D-W. VA)	225-6472	Sen. Public Works

House Conferees

Harley Staggers (D-W.VA)	225-4331	Interstate & Foreign Commerce
John Dingell (D-Mich)	225-4071	Interstate & Foreign Commerce
Torbert MacDonald (D-Mass)	225-2836	Interstate & Foreign Commerce
John Moss (D-Calif)	225-7163	Interstate & Foreign Commerce
Paul Rogers (D-Fl)	225-3001	Interstate & Foreign Commerce
Clarence Brown (R-Ohio)	225-4324	Interstate & Foreign Commerce
James Broyhill (R-NC)	225-2576	Interstate & Foreign Commerce

(Staff Note: Exhibits 8.05 through 8.15 retained in committee files. These exhibits are examples of FASB correspondence with various agencies.)

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(page 1 of 3)

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

General Statement regarding the Financial Accounting Standards Board's "Meetings with Prominent Public Accountants, Businessmen, and Members of the Academic Community"

The Standards Board is responsible for establishing standards of financial accounting and reporting. In performing this function, the FASB seeks a balance among the perceived needs of users of financial information, the perceived practicability of implementation by preparers of financial information, and the perceived ability of independent auditors to attest to the reliability of financial information. These perceptions must be kept sharp by a continuing dialogue with representative members of the user, preparer, and auditor groups, accounting educators, government officials, and other interested and knowledgeable persons and groups. The Board's Rules of Procedure provide for such input on a broad basis with regard to specific technical projects. However, input also is required by the Board with regard to the overall direction of its efforts, priorities, and methods of operation.

The purpose of the Financial Accounting Standards Advisory Council, which is not a decision-making body, is to advise the Board with respect to agenda items, priorities, task forces and the like. The Advisory Council is broadly representative of users, preparers, and auditors of financial information, as well as the academic community and government, but because Council is necessarily limited in size (32 members at present), the FASB considers it necessary to engage in continuing dialogue with a broader cross section of interested groups.

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(page 2 of 3)

Accordingly, meetings have been held or are being scheduled with public accountants, businessmen, and academicians. These meetings are conceived as a two-way channel of communication. They provide the Board with an opportunity to inform those directly concerned as to priorities and the reasons for them, status of work in progress, and problems confronting the Board. They also provide an opportunity for interested groups to convey their observations, including criticisms and disagreements, concerning the Board's priorities and operations. However, the Board does not share its responsibility for issuing Statements and Interpretations with any outside parties in the private sector.

Groups with which such meetings have been held, and the names of persons attending those meetings, are shown as Exhibit 9.01. The groups with which such meetings are scheduled in the future, and the dates, are shown as Exhibit 9.02.

The Standards Board also holds meetings with individuals and groups for the purpose of obtaining information about specific technical subjects. For example, Ezra Solomon discussed with the Board the economic implications of changes in exchange rates; Professor William Beaver discussed the efficient market theory; representatives of the American Academy of Actuaries discussed catastrophe reserves and mortality fluctuation reserves; and representatives of the American Appraisal Co. discussed accounting research and appraisal techniques.

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(page 3 of 3)

One of the concerns of the FASB is to identify significant new problems of accounting and reporting on a timely basis. Because their broad range of practice tends to confront auditors with emerging problems at an early stage, members of the FASB and its staff meet regularly with the Accounting Standards Executive Committee of the AICPA.

As described in Exhibit 8, the Standards Board and its staff conduct meetings from time to time on an "as requested" basis with the Commissioners and staff of the SEC and the members and staff of the CASB.

In meeting with the broad range of individuals and organizations described above, the FASB's intent is to have direct contact with responsible representatives of groups having a capability to provide meaningful information and insight concerning the establishment of financial accounting standards. Therefore, meetings have not been held or planned with persons or groups other than those who are knowledgeable about the problems and requirements of financial accounting and reporting.

As a matter of policy, the Standards Board and its staff do not render private interpretations or advisory opinions concerning financial accounting and reporting standards if requested to do so by auditors and preparers.

Exhibit 9.01
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FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Meetings Held with "Prominent Public Accountants, Businessmen, and Members of the Academic Community"

As of May 15, 1976

Listed below are meetings already held by the FASB, or certain of its members, with prominent public accountants, businessmen, and members of the academic community for the purpose of two-way communication concerning priorities and the reasons for them, status of work in progress, and problems confronting the Board. (See Exhibit 9 for a general discussion of the purpose of such meetings.) As a matter of policy, the FASB does not render private interpretations or advisory opinions concerning financial accounting and reporting standards if requested to do so by auditors and preparers.

January 30, 1975 -- Meeting with Representational Organizations

Participants:

Name	Affiliation
Wilton T. Anderson	American Accounting Association/ Professor, Oklahoma State University
R. Lee Brummet	American Accounting Association/ Professor, University of North Carolina
Paul L. Gerhardt	American Accounting Association
John Lawler	American Institute of Certified Public Accountants
Wallace E. Olson	American Institute of Certified Public Accountants
John W. Cooley	Federal Government Accountants Association (now Association of Government Accountants)/Department of Defense
Chris S. Peratino	Federal Government Accountants Association (now Association of Government Accountants)/Smithsonian Institution
Kenneth R. Ketcham	Federal Government Accountants Association (now Association of Government Accountants)/current affiliation unknown

January 30, 1975 -- Meeting with Representational Organizations (Concluded)

Participants:

Name	Affiliation
Ivan O. Bull	Financial Accounting Foundation/ American Institute of Certified Public Accountants/McGladrey, Hansen, Dunn & Co.
Philip L. Defliese	Financial Accounting Foundation/ American Institute of Certified Public Accountants/Coopers & Lybrand
James Don Edwards	Financial Accounting Foundation/ Professor of Accounting, University of Georgia
Ralph E. Kent	Financial Accounting Foundation/ Arthur Young & Company
Thomas C. Pryor	Financial Accounting Foundation/ White, Weld & Co., Incorporated
Wilbert A. Walker	Financial Accounting Foundation/ Retired
Robert D. Hedberg	Financial Analysts Federation/ Hedberg & Associates
Charles C. Hornbostel	Financial Executives Institute
Edward J. Mack	Financial Executives Institute/ Burlington Industries
John D. Bradt	The Institute of Internal Auditors/ Imperial Oil Limited
John E. Harmon	The Institute of Internal Auditors
C. N. Inman	The Institute of Internal Auditors/ Eckerc Scory Ransom & Ingrum
Arthur P. Bartholomew	National Association of Accountants/ Ernst & Ernst
John E. Vavasour	National Association of Accountants
William M. Young, Jr.	National Association of Accountants

Exhibit 9.01
(page 3 of 8)

March 1, 1975 -- Meeting with Representatives of Accounting Firms (AICPA Sponsored)

Participants:

Name	Affiliation
Richard T. Baker	Ernst & Ernst
John C. Biegler	Price Waterhouse & Co.
Michael N. Chetkovich	Haskins & Sells
Philip L. Defliese	Coopers & Lybrand
Walter E. Hanson	Peat, Marwick, Mitchell & Co.
Harvey E. Kapnick, Jr.	Arthur Andersen & Co.
Ralph E. Kent	Arthur Young & Company
A.E. MacKay	Main Lafrentz & Co.
William R. Mette, Jr.	Alexander Grant & Company
Russell E. Palmer, Jr.	Touche Ross & Co.
Joseph F. Spilberg	Laventhol & Horwath
Wallace E. Olson	American Institute of Certified Public Accountants
John Lawler	American Institute of Certified Public Accountants
Stanley D. Robinson	Kaye, Scholer, Fierman, Hays & Handler

March 14, 1975 -- National Council on Governmental Accounting

Participants:

Name	Affiliation
Donald Beatty	Municipal Finance Officers Association
Robert Greene	Director of Finance, Daly City, California

Exhibit 9.01
(page 4 of 8)

June 5, 1975 -- Public Review Board of Arthur Andersen & Co.

Participants:

Name	Affiliation
William L. Cary	Professor of Law Columbia University
James Don Edwards	Professor of Accounting University of Georgia
George Romney	National Center for Voluntary Action
Randolph W. Thrower	Sutherland, Asbill & Brennan
Newton N. Minow	Sidley & Austin

September 18, 1975 -- Honeywell, Inc. and Haskins & Sells

Participants:

Name	Affiliation
James H. Grenell	Honeywell, Inc.
William Mackey	Honeywell, Inc.
Daniel McBride	Honeywell, Inc.
John Morrison	Honeywell, Inc.
Fred W. Bassinger	Haskins & Sells
D. B. Johnson	Haskins & Sells
D. R. Johnson	Haskins & Sells

December 5, 1975 -- Walter Hanson of Peat, Marwick, Mitchell & Co.

Participants:

Name	Affiliation
Walter Hanson	Peat, Marwick, Mitchell & Co.

Exhibit 9.01
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December 10, 1975 -- Arthur Andersen & Co.

Participants:

Name	Affiliation
George Catlett	Arthur Andersen & Co.
Harvey Kapnick	Arthur Andersen & Co.
Arthur Wyatt	Arthur Andersen & Co.

January 7, 1976 -- Meeting with Representatives of Accounting Firms (AICPA Sponsored)

Participants: (Note: Those listed below are members of the group with which the meeting was held. The FASB does not have a record of those who were in attendance.)

Name	Affiliation
Richard T. Baker	Ernst & Ernst
John C. Biegler	Price Waterhouse & Co.
Richard S. Hickok	Hurdman and Cranstoun
Michael N. Chetkovich	Haskins & Sells
Philip L. Defliese	Coopers & Lybrand
Walter E. Hanson	Peat, Marwick, Mitchell & Co.
Harvey E. Kapnick	Arthur Andersen & Co.
Ralph E. Kent	Arthur Young & Company
William R. Mette	Alexander Grant & Company
Russell E. Palmer	Touche Ross & Co.
Joseph F. Spilberg	Laventhol & Horwath
Bernard Z. Lee	Seidman & Seidman
Arnold I. Levine	J. K. Lasser & Company
A. E. MacKay	Main Lafrentz & Co.
Harry Mancher	S. D. Leidesdorf & Co.
Wallace E. Olson	American Institute of Certified Public Accountants
Gilbert Simonetti, Jr.	American Institute of Certified Public Accountants
Kenneth J. Bialkin	Willkie, Farr & Gallagher

Exhibit 9.01
(page 6 of 8)

January 28, 1976 -- Meeting with Representational Organizations

Participants:

Name	Affiliation
Wilton T. Anderson	American Accounting Association/ Professor, Oklahoma State University
Charles T. Horngren	American Accounting Association/ Professor, Stanford University
Paul L. Gerhardt	American Accounting Association
Ivan O. Bull	American Institute of Certified Public Accountants/Financial Accounting Foundation/ McGladrey, Hansen, Dunn & Co.
John Lawler	American Institute of Certified Public Accountants
Wallace E. Olson	American Institute of Certified Public Accountants
Nathan Cutler	Association of Government Accountants
Chris S. Peratino	Association of Government Accountants/ Smithsonian Institution
Donald L. Scantlebury	Association of Government Accountants/ U. S. General Accounting Office, Division of Finance & General Management Studies
Richard T. Baker	Financial Accounting Foundation/ Ernst & Ernst
John C. Biegler	Financial Accounting Foundation/ Price Waterhouse & Co.
James Don Edwards	Financial Accounting Foundation/ Professor of Accounting, University of Georgia
William H. Franklin	Financial Accounting Foundation/ Retired
Ralph E. Kent	Financial Accounting Foundation/ Arthur Young & Company
Stanley J. Scott	Financial Accounting Foundation/ Alfred, Meroney & Company
Walter P. Stern	Financial Accounting Foundation/ Capital Research Company

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Exhibit 9.01
(page 7 of 8)

January 28, 1976 -- Meeting with Representational Organizations (Concluded)

Participants:

Name	Affiliation
Wilbert A. Walker	Financial Accounting Foundation/ Retired
William S. Gray, III	Financial Analysts Federation/ Harris Trust & Savings Bank
Theodore R. Lilley	Financial Analysts Federation
Daniel F. Crowley	Financial Executives Institute/ McGraw-Hill
J. O. Edwards	Financial Executives Institute/ Exxon Company, U.S.A.
Charles C. Hornbostel	Financial Executives Institute
John D. Bradt	The Institute of Internal Auditors/ Imperial Oil Limited
Stanley C. Gross	The Institute of Internal Auditors/ Sherwin-Williams Co.
John E. Harmon	The Institute of Internal Auditors
Lafe P. Fox	National Association of Accountants/ PMC Industries
John E. Vavasour	National Association of Accountants
William M. Young, Jr.	National Association of Accountants

March 30, 1976 -- Council of Financial Executives of the Conference Board

Participants:

Name	Affiliation
Joseph F. Abely, Jr.	General Foods Corporation
James J. Kerley	Monsanto Company
Keith R. Potter	International Harvester Company
John Sagan	Ford Motor Company
Gordon R. Worley	Marcor Inc.

Exhibit 9.01
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April 12, 1976 -- Financial Executives Institute

Participants:

Name	Affiliation
W. Warren Brown	American Telephone & Telegraph Company
E. J. Donohue	Ogden Corporation
J. O. Edwards	Exxon Company, U.S.A.
Charles C. Hornbostel	Financial Executives Institute
E. J. Mack	Burlington Industries
Fred W. Miller	Arkwright-Boston Insurance Co.
Joseph A. Sciarrino	Financial Executives Institute
Robert C. Thompson	Shell Oil Company
E. A. Vaughn	Aluminum Co. of America

Exhibit 9.02
(page 1 of 2)

FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Meetings Scheduled to be Held with "Prominent Public Accountants, Businessmen, and Members of the Academic Community"

As of May 15, 1976

Listed below are meetings scheduled to be held by the FASB, or certain of its members, with prominent public accountants, businessmen, and members of the academic community. (See Exhibit 9 for a general discussion of the purpose of such meetings.) As a matter of policy, the FASB does not render private interpretations or advisory opinions concerning financial accounting and reporting standards if requested to do so by auditors and preparers.

June 16, 1976 -- Meeting with Representatives of Accounting Firms (AICPA Sponsored)

Participants: (Note: Members of the group with which the meeting is scheduled.)

Name	Affiliation
Hearld R. Ambler	Baird, Kurtz & Dobson
Peter Arnstein	John F. Forbes & Company
Sol Bergstein	Eisner & Lubin
Warran Bolmgren	Broeker Hendrickson & Co.
Ivan O. Bull	McGladrey, Hansen, Dunn & Co.
Robert M. Coffman	Elmer Fox, Westheimer & Co.
Robert L. Coker	Clifton, Gunderson & Co.
Arthur J. Dixon	Oppenheim, Appel, Dixon & Co.
Joseph Gerber	Plante & Moran
Harry Grossman	Altschuler, Melvoin & Glasser
William S. Holland	Cherry, Bekaert & Holland
C. Everett Johnson	Harris, Kerr, Forster & Co.
Joseph S. Kirchheimer	A. M. Pullen & Company
Irving B. Kroll	Kenneth Laventhal & Company
Robert A. Liberty	Moss, Adams & Co.

Exhibit 9.02
(page 2 of 2)

June 16, 1976 -- Meeting with Representatives of Accounting Firms (AICPA Sponsored) (Concluded)

Participants:

Name	Affiliation
Edward M. London	Lester Witte & Company
Richard P. Miller	Wolf and Company
Stanley J. Scott	Alford, Meroney & Company
Saul S. Silverman	Clarence Rainess & Co.
John J. van Benten	Geo. S. Olive & Co.
Stanley Weinstein	Fred Landau & Co.
Wallace E. Olson	American Institute of Certified Public Accountants
Donald J. Schneeman	American Institute of Certified Public Accountants

July 1, 1976 -- Arthur Young & Company

Participants:

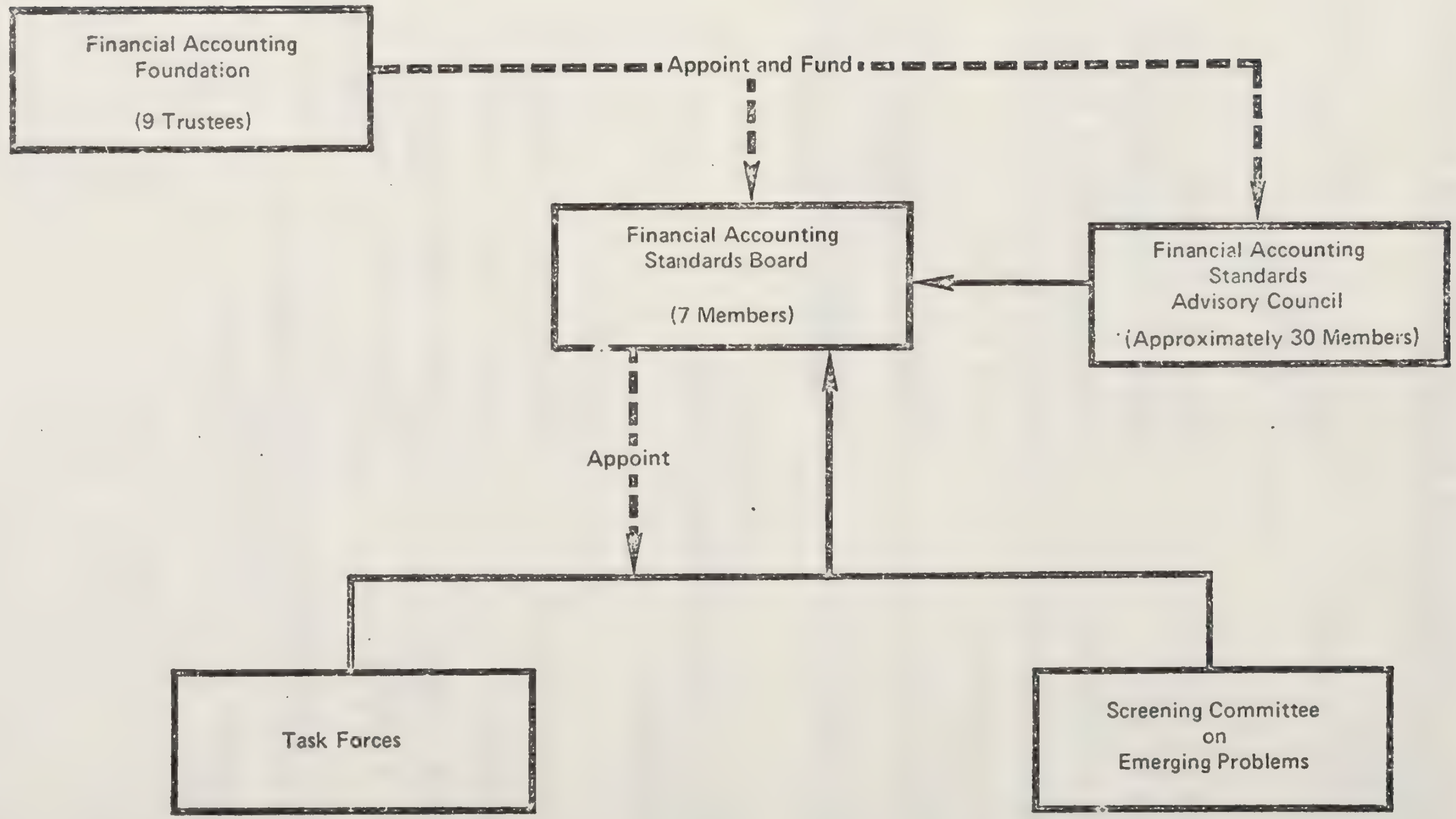
Name	Affiliation
Charles G. Gillette	Arthur Young & Company
Ernest Hicks	Arthur Young & Company
William S. Kanaga	Arthur Young & Company
Fred L. Tepperman	Arthur Young & Company

September 27 or 28, 1976 -- Business Round Table

Participants: Not as yet identified.

Appendix A
(page 1 of 3)

Financial Accounting Foundation
Financial Accounting Standards Board
Financial Accounting Standards Advisory Council

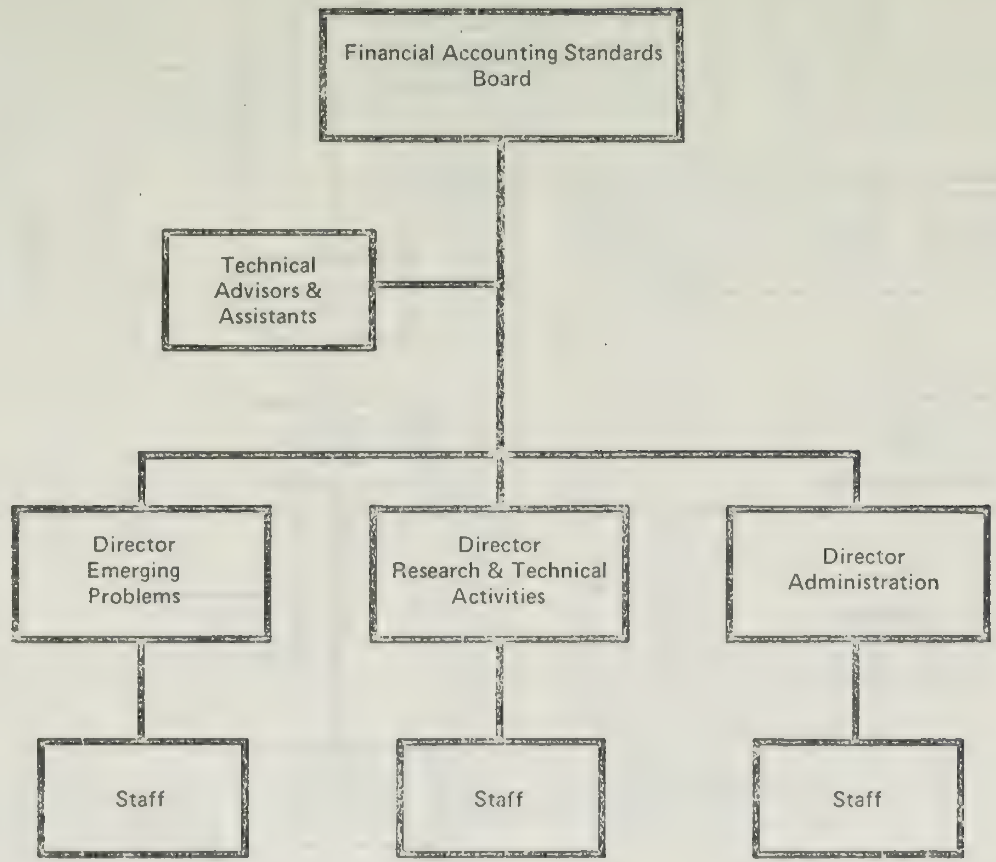


Issued April 15, 1976

Chart No. 1

Appendix A
(page 2 of 3)

Financial Accounting Standards Board
Organizational Structure



Issued April 15, 1976

Chart No. 2

Appendix A
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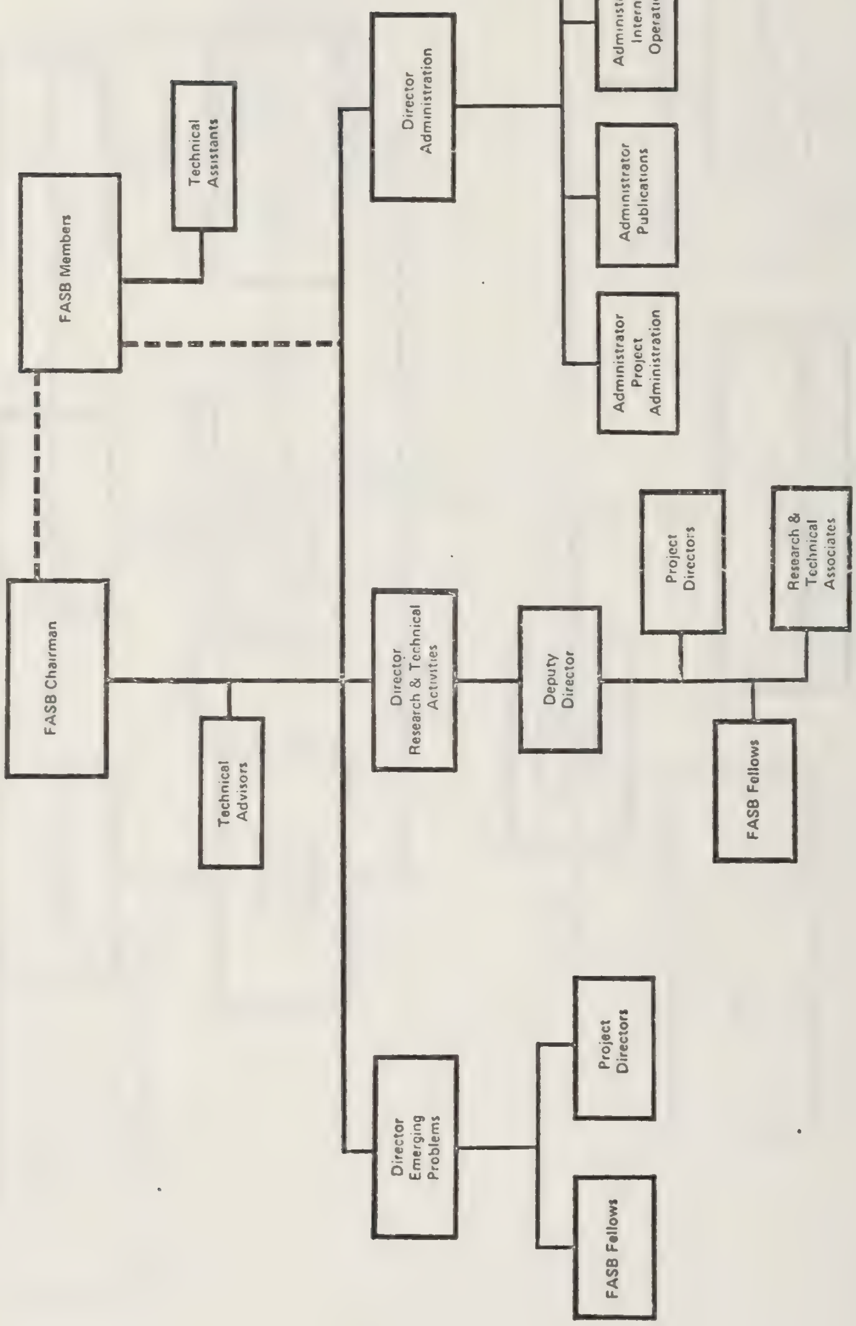
Chart No. 3

Financial Accounting Standards Board
Organizational Structure



Issued April 15, 1976

FAF-FASB Annual Report--1975

HASKINS & SELLS CERTIFIED PUBLIC ACCOUNTANTS
One North Broadway, White Plains, New York 10601

Auditors' Opinion

To the Board of Trustees of
Financial Accounting Foundation

We have examined the statement of financial position of the Financial Accounting Foundation as of December 31, 1975 and 1974 and the related statements of revenue, expenses and changes in general fund balance and of changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of the Foundation at December 31, 1975 and 1974 and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

February 20, 1976

Haskins & Sells

STATEMENT OF FINANCIAL POSITION

	December 31	
	1975	**1974**
Current Assets:		
Cash, including certificates of deposit of $2,000,000 and $2,400,000 at December 31, 1975 and 1974, respectively	$2,140,323	$2,620,759
Interest receivable	65,633	46,898
Subscription, publication and royalty receivables, less allowance for doubtful accounts of $15,000 at December 31, 1975	498,472	115,011
Contributions receivable (Note 1)	101,650	—
Prepaid expenses and other current assets	51,917	65,646
Total current assets	2,857,995	2,848,314
Current Liabilities:		
Accounts payable	261,554	151,172
Withheld and accrued employee benefits	169,520	169,469
Other current liabilities and accrued expenses	55,593	93,545
Deferred contributions (Note 1)	200,000	—
Deferred subscriptions (Note 1)	228,854	201,539
Total current liabilities	915,521	615,725
Working Capital	1,942,474	2,232,589
U.S. Treasury Notes (7⅞% and 8¾%, due in 1978), at cost which approximates market	2,056,187	—
Furniture, Equipment and Leasehold Improvements, at cost less accumulated depreciation and amortization (Note 4)	439,010	463,771
General Fund Balance	$4,437,671	$2,696,360

The accompanying Notes to Financial Statements are an integral part of this statement.

STATEMENT OF REVENUE, EXPENSES AND CHANGES IN GENERAL FUND BALANCE

	Year Ended December 31	
	1975	1974*
Revenue:		
Contributions (Note 1)	$4,129,201	$3,984,294
Interest income	261,461	223,486
Subscription and publication sales, net of direct costs of $506,401 and $182,280 in 1975 and 1974, respectively (Note 1)	632,703	167,064
Royalties from publishers	231,646	—
Total	5,255,011	4,374,844
Expenses:		
Financial Accounting Standards Board (Note 3):		
Salaries and related expenses:		
Salaries and wages	2,165,956	1,952,714
Employee benefits and employment costs ($44,020 in 1975 and $41,864 in 1974)	270,759	287,593
	2,436,715	2,240,307
Occupancy and equipment expenses:		
Rental of office space, furniture and equipment	299,436	294,098
Telephone, electricity and maintenance	108,847	97,721
Depreciation and amortization (Note 1)	55,520	56,842
	463,803	448,661
Other operating expenses:		
Legal, audit, research and other professional fees	132,993	111,401
Office supplies and photocopies	90,484	79,997
Printing costs, excluding those related to subscription and publication sales	70,912	55,847
Travel and meetings	63,279	68,681
Postage, parcel and wire service	61,219	32,786
Research material and systems	26,395	36,343
Other	69,637	40,909
	514,919	425,964
Total Standards Board	3,415,437	3,114,932
Financial Accounting Foundation (including salaries and benefits of $44,208 in 1975 and $39,200 in 1974)	98,263	97,092
Total	3,513,700	3,212,024
Excess of Revenue Over Expenses	1,741,311	1,162,820
General Fund Balance at Beginning of Year	2,696,360	1,533,540
General Fund Balance at End of Year	$4,437,671	$2,696,360

*Minor reclassifications have been made in 1974 to conform to the 1975 presentation.

The accompanying Notes to Financial Statements are an integral part of this statement.

STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year Ended December 31	
	1975	**1974**
Source of Working Capital:		
Excess of revenue over expenses	$1,741,311	$1,162,820
Charge not requiring current outlay of working capital—depreciation and amortization	55,520	56,842
Total source of working capital	1,796,831	1,219,662
Use of Working Capital:		
Purchase of U.S. Treasury Notes	2,056,187	—
Expenditures for furniture, equipment and leasehold improvements	30,759	24,510
Total use of working capital	2,086,946	24,510
Increase (Decrease) in Working Capital	(290,115)	1,195,152
Working Capital at Beginning of Year	2,232,589	1,037,437
Working Capital at End of Year	$1,942,474	$2,232,589
Increases (Decreases) in Working Capital Are Summarized by Components Below:		
Cash and interest receivable	$ (461,701)	$1,215,540
Subscription, publication and royalty receivables	383,461	51,882
Contributions receivable	101,650	—
Other assets	(13,729)	32,388
Accounts and other payables	(72,481)	(26,906)
Deferred contributions	(200,000)	50,000
Deferred subscription revenue	(27,315)	(127,752)
	$ (290,115)	$1,195,152

The accompanying Notes to Financial Statements are an integral part of this statement.

Notes to Financial Statements

1. Accounting Policies

The significant accounting policies followed in preparing the accompanying financial statements are summarized below.

Presentation. The financial statements include the activities of the Financial Accounting Standards Board ("Standards Board") and the Financial Accounting Standards Advisory Council ("Advisory Council").

The Statement of Revenue, Expenses and Changes in General Fund Balance sets forth separately the expenses of the Foundation and the Standards Board, including the Advisory Council, thereby giving recognition to their separate responsibilities as described in the Certificate of Incorporation and By-Laws of the Foundation.

Basis of Accounting. The financial statements have been prepared on the accrual basis of accounting.

Contributions. Contributions received in the current period but specified as support for a subsequent period are deferred. Commitments for support of future periods are not recorded. Commitments for contributions made currently for support of the current year's activities are accrued at year-end to the extent that their future collectibility is reasonably certain and determinable.

Subscriptions. Revenues from publication subscriptions are taken into income on a pro rata basis over the 12-month subscription period. Costs of subscription fulfillment are recorded when incurred.

Depreciation and Amortization. Depreciation and amortization of furniture, equipment and leasehold improvements is provided on a straight-line basis over their estimated useful lives or the remaining term of the lease, whichever is appropriate.

Pensions. The Foundation has a funded, non-contributory pension plan covering all staff personnel and a funded, non-contributory retirement income plan covering members of the Standards Board. The annual pension provision for the staff plan is determined based on actuarial cost methods and includes interest on unfunded past service cost. The annual retirement income plan provision is equal to 10% of the annual compensation of the members of the Standards Board and is used to purchase annuities.

Donated Services. A substantial number of people have donated significant amounts of time to the activities of the Foundation and the Standards Board. No value has been reflected in the statements for these donated services because there is no clearly measurable basis to determine the amount.

2. Organization and Tax Status

The Foundation was incorporated on June 30, 1972, under the Delaware General Corporation Law to operate exclusively for charitable, educational, scientific and literary purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1954. The Internal Revenue Service has determined that the Foundation is exempt from Federal income tax under the aforementioned Section 501(c)(3).

3. Functional Expenses

The following summary shows the distribution of the Standards Board's expenses by the functional unit involved.

	Year Ended December 31	
	1975	1974
Board, Technical and Research	$2,076,345	$1,980,918
Advisory Council	8,925	4,957
Communications, including gratis distribution of discussion memoranda and exposure drafts	254,466	164,088
Administration and General	623,238	531,045
Expenses Allocated to Functions	2,962,974	2,681,008
Space and Utility Costs Common to All Functions	452,463	433,924
	$3,415,437	$3,114,932

Other common costs, such as legal and other professional fees, insurance, and office supplies and photocopy costs have been included in "Administration and General" in the above summary.

4. Furniture, Equipment and Leasehold Improvements

	December 31	
	1975	1974
Furniture and equipment	$297,448	$277,785
Leasehold improvements	274,457	263,361
	571,905	541,146
Accumulated depreciation and amortization	(132,895)	(77,375)
	$439,010	$463,771

5. Pension and Retirement Income Plans

Pension expense was $132,000 in 1975 and $145,000 in 1974. At December 31, 1975 and 1974, assets of the funds exceeded vested benefits. The Foundation's policy is to fund pension and retirement income plan expenses currently. The aforementioned pension and retirement income plans comply in all material respects with the provisions of the Employee Retirement Income Security Act of 1974.

6. Lease Commitment

The Foundation occupies office space under the terms of a ten-year lease expiring July 1983. The lease provides for annual rental payments of approximately $280,000, plus escalation for the Foundation's pro rata share ($900 in 1975 and $1,100 in 1974) of the landlord's increased operating expenses and real estate taxes. The Foundation has an option to terminate the lease in July 1978 upon payment of $138,000.

(Staff Note: 1973 and 1974 reports retained in committee files.)

Certificate of Incorporation | By-Laws

Financial Accounting Foundation Certificate of Incorporation | By-Laws

Issued by the Board of Trustees
Financial Accounting Foundation
HIGH RIDGE PARK, STAMFORD, CONNECTICUT 06905

Contents

Certificate of Incorporation*
of
Financial Accounting Foundation

FIRST: The name of the corporation (the "Corporation") is FINANCIAL ACCOUNTING FOUNDATION.

SECOND: The address of the registered office of the Corporation in the State of Delaware is No. 100 West Tenth Street, in the City of Wilmington, County of New Castle, and the name of its registered agent at such address is The Corporation Trust Company.

THIRD: The Corporation is organized to operate exclusively for charitable, educational, scientific and literary purposes, within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue law). In particular, the purposes of the Corporation shall be to advance and to contribute to the education of the public, investors, creditors, preparers and suppliers of financial information, reporting entities and certified public accountants in regard to standards of financial accounting and reporting; to establish and improve the standards of financial accounting and reporting by defining, issuing and promoting such standards; to conduct and commission research, statistical compilations and other studies and surveys; and to sponsor meetings, conferences, hearings and seminars, in respect of financial accounting and reporting.

Without limiting the powers the Corporation may lawfully exercise, the Corporation shall have the power to take and receive funds from any source including the Government of the United States, the governments of the States, local governments, charitable or educational organizations (including foundations), trade and professional associations, business corporations, partnerships and individuals.

* As amended effective April 18, 1973, pursuant to action of the Board of Trustees of the Financial Accounting Foundation.

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Consistent with the above, the Corporation may exercise all powers available to non-profit, non-stock corporations organized under the Delaware General Corporation Law.

FOURTH: The Corporation shall be a non-stock Corporation without authority to issue capital stock. The members of the Board of Directors of the American Institute of Certified Public Accountants shall ex officio constitute the members of the Corporation; their voting rights as members of the Corporation shall be limited to the election and removal of members of the Board of Trustees as elsewhere provided in this Certificate of Incorporation and the By-Laws of the Corporation.

FIFTH: The names and mailing addresses of the incorporators of the Corporation are:

Name	*Mailing Address*
Marshall S. Armstrong	Geo. S. Olive & Co. 320 North Meridian Street Indianapolis, Indiana 46204
John C. Biegler	Price Waterhouse & Co. 1251 Avenue of the Americas New York, New York 10020
Winston Brooke	Brooke & Freeman 303 East 11th Street Anniston, Alabama 36201
LeRoy Layton	Main Lafrentz & Co. 280 Park Avenue New York, New York 10017
Walter J. Oliphant	Arthur Andersen & Co. 69 West Washington Street Chicago, Illinois 60602

The incorporators shall manage the affairs of the Corporation and do whatever is necessary and proper to perfect the organization of the Corporation, including the adoption of the initial By-Laws of the Corporation, until the appointment of the initial members of the Board of Trustees of the Corporation.

SIXTH: There shall be a Financial Accounting Standards Board to which there is hereby delegated all authority, functions and powers of the Corporation and the Board of Trustees in respect of standards of financial accounting and reporting, including the conduct of all activities relating thereto; and there shall be a Financial Accounting Standards Advisory Council whose members, as provided by the By-Laws, shall work in an advisory capacity with the Financial Accounting Standards Board. The composition of the Financial Accounting Standards Board and the Financial Accounting Standards Advisory Council, and the exercise of the authority, functions and powers delegated to the Financial Accounting Standards Board and the nature of the advisory function of the members of the Financial Accounting Standards Advisory Council, shall be as provided in or pursuant to the By-Laws of the Corporation. Subject to such conditions as may be specified therein, the By-Laws shall authorize the Board of Trustees of the Corporation initially to adopt, and the Financial Accounting Standards Board thereafter to adopt, alter, amend, supplement and repeal, rules of procedure of the Financial Accounting Standards Board with respect to the Financial Accounting Standards Board establishing and improving standards of financial accounting and reporting and otherwise carrying out the authority, functions and powers delegated to it by this Certificate of Incorporation.

SEVENTH: (a) The governing body of the Corporation shall be its Board of Trustees. A full Board of Trustees shall consist of nine members. The business and affairs of the Corporation shall be managed by the Board of Trustees except to the extent that authority, functions and powers shall be assigned or delegated pursuant to this Certificate of Incorporation or the By-Laws. No member of the Board of Trustees shall serve simultaneously on the Board of Trustees and on either the Financial Accounting Standards Board or the Financial Accounting Standards Advisory Council.

(b) The senior elected officer of the American Institute of Certified Public Accountants who is not an employee thereof shall, so long as he holds such office, be, ex officio, a member of the Board of Trustees. There shall be eight other members of the full Board of Trustees who shall be elected for three-year terms (subject to any provisions in the By-Laws) by the members of the Corporation as follows: four shall be certified public accountants in public practice at the time of their election; two shall be or, in the

judgment of the members of the Corporation, have extensive experience as financial executives, one of whom shall be nominated by the Financial Executives Institute and the other by the National Association of Accountants; one shall be or, in the judgment of the members of the Corporation, have extensive experience as a financial analyst, and shall be nominated by the Financial Analysts Federation; and one shall be or, in the judgment of the members of the Corporation, have extensive experience as an accounting educator, and shall be nominated by the American Accounting Association. Nominations and the rights of such organizations in respect of nominations shall be subject to and as prescribed in the By-Laws of the Corporation, and vacancies in the Board of Trustees shall be filled in the manner prescribed in the By-Laws. The By-Laws may provide that the elected members of the Board of Trustees shall be divided into three classes with the term of office of each class to expire in successive years.

EIGHTH: (a) The Corporation shall not have or exercise any power or authority either expressly, by interpretation, or by operation of law, nor shall it directly or indirectly engage in any activity that would prevent it from qualifying (and continuing to qualify) as a corporation described in Section 501(c)(3) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue law), contributions to which are deductible for Federal Income Tax purposes.

(b) No part of the net earnings of the Corporation shall inure to the benefit of or be distributable to its incorporators, trustees, officers, members or other private persons within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1954 (or any such future corresponding provision), except that the Corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in Article Third hereof.

(c) No substantial part of the activities of the Corporation shall consist of carrying on propaganda, or otherwise attempting to influence legislation; nor shall it in any manner or to any extent participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

(d) Neither the whole, nor any part or portion, of the assets or net earnings of the Corporation shall be used, nor shall the Corporation ever be organized or operated, within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1954 (or any such future corresponding provision), for purposes or objects other than those set out in Article Third hereof.

(e) If the Corporation shall during any period be treated as a private foundation as defined in Section 509(a) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue law), the Corporation shall during any such period:

(1) distribute its income for each taxable year at such time and in such manner as not to become subject to the tax on undistributed income imposed by Section 4942 of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue law).

(2) not engage in any act of self-dealing as defined in Section 4941(d) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue law).

(3) not retain any excess business holdings as defined in Section 4943(c) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue law).

(4) not make any investments in such manner as to subject it to tax under Section 4944 of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue law).

(5) not make any taxable expenditures as defined in Section 4945(d) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue law).

NINTH: In the event the Corporation shall be dissolved, any assets of the Corporation remaining after all obligations of the Corporation shall have been paid, or otherwise adequately provided for, shall be distributed, or they shall be sold and the net proceeds therefrom shall be distributed, for purposes or to organizations with

purposes related to the purposes of the Corporation and qualifying as exempt purposes or organizations for purposes of Section 501(c)(3) of the Internal Revenue Code and the regulations thereunder, as the same now exist or as they may be amended from time to time.

TENTH: Except as otherwise provided by Article Fifth of this Certificate of Incorporation, the power to adopt, alter, amend, supplement and repeal the By-Laws of the Corporation shall be vested exclusively in the Board of Trustees. Unless the By-Laws otherwise provide, any such adoption, alteration, amendment, supplement or repeal shall require the approval of eight members of the Board of Trustees.

ELEVENTH: The Corporation reserves the right to amend this Certificate of Incorporation, and thereby to change or repeal any provision herein contained from time to time, in the manner prescribed at the time by statute, and all rights conferred upon any person herein are granted subject to this reservation; provided, however, that any amendment hereto must be approved by eight members of the Board of Trustees. Power to amend this Certificate of Incorporation shall be vested exclusively in the Board of Trustees.

The undersigned, being the incorporators hereinabove named, have executed and acknowledged this Certificate of Incorporation, pursuant to Section 103(b)(2) of the Delaware General Corporation Law, as of the date or dates hereinbelow set forth.

/s/ Marshall S. Armstrong June 27, 1972

/s/ John C. Biegler June 29, 1972

/s/ Winston Brooke June 27, 1972

/s/ LeRoy Layton June 27, 1972

/s/ Walter J. Oliphant June 27, 1972

FINANCIAL ACCOUNTING FOUNDATION

(A non-stock Delaware corporation)

BY-LAWS*

CHAPTER A | ARTICLE I-A

BOARD OF TRUSTEES

Section 1. *Powers.* The business and affairs of the Financial Accounting Foundation (hereinafter referred to in these By-Laws as the "Foundation") shall be managed by its Board of Trustees (such Board and the members thereof collectively and individually being from time to time referred to in these By-Laws as "the Trustees") which may exercise all authority and powers, and perform all functions, of the Foundation and do such lawful acts and things as are not by the Certificate of Incorporation or by these By-Laws directed or required to be exercised or performed by the Financial Accounting Standards Board (hereinafter from time to time referred to in these By-Laws as the "FASB") or by the members of the Financial Accounting Standards Advisory Council (hereinafter from time to time referred to in these By-Laws as the "Council") in their advisory capacity. The Trustees shall arrange for financing of the Foundation and shall have power of approval over its annual budget, and the annual budget of the FASB and the Council as prepared and presented by the Chairman of the FASB; provided, however, that the Trustees shall not, by or in connection with the exercise of their power of approval over such annual budgets, direct the FASB to undertake or to omit to undertake any particular project or activity or otherwise affect the exercise by the FASB of its functions and powers in respect of standards of financial accounting and reporting. The Trustees shall also review periodically the By-Laws of the Foundation and the basic structure of establishing and improving standards of financial accounting and reporting.

Section 2. *Number and Election.* The number of Trustees which shall constitute a full Board of Trustees shall be nine, including the senior elected officer of the American Institute of Certified Public Accountants (hereinafter from time to time referred to in these By-Laws

* As amended effective March 29, 1973, pursuant to action of the Board of Trustees of the Financial Accounting Foundation.

as the "AICPA") who is not an employee thereof, who shall, so long as he holds such office, serve ex officio. Each other Trustee, except as provided in Sections 5 and 7 of this Article, shall be elected, at a meeting of the members of the Foundation (hereinafter from time to time collectively referred to as the "Electors") held after the July 1 and on or prior to the September 30 next preceding the commencement of his term, to a term expiring on September 30 in the third calendar year from the year of his election (and until his successor is elected), by vote of a simple majority of all Electors serving, pursuant to the procedures set forth in Sections 4, 5 and 7 of this Article and Article III-B of Chapter B of these By-Laws. The terms of elected Trustees shall be staggered in such manner that the terms of not more than three elected Trustees shall expire on September 30 in any one year. Subject to Section 5 of this Article, no elected Trustee shall be removed from office except on the vote of two-thirds of all Electors serving and then only by reason of disability (which in the opinion of a physician selected by such Electors will continue for a period of at least six consecutive months from the commencement of such disability), malfeasance or alleged malfeasance in office, or other cause deemed by such Electors as reasonably evidencing conduct detrimental to the purposes or repute of the Foundation or the Financial Accounting Standards Board. The ex officio Trustee at any time shall hold office as Trustee only so long as he shall be the senior elected officer of the American Institute of Certified Public Accountants who is not an employee thereof. Each Trustee, including the ex officio Trustee, shall have one vote on each matter presented to the Trustees for their action.

Section 3. *Qualifications.* Of the eight elected Trustees on a full Board, four shall be certified public accountants in public practice at the time of their election; two shall be or, in the judgment of the Electors, have extensive experience as financial executives; one shall be or, in the judgment of the Electors, have extensive experience as a financial analyst; and one shall be or, in the judgment of the Electors, have extensive experience as an accounting educator. No Trustee shall be elected to a third consecutive full three-year term. Membership on the Board of Trustees shall be personal to the persons elected thereto and no Trustee shall have any power of substitution or delegation of authority as a Trustee.

Section 4. *Nominations and Elections.* The four elected Trustees who are to be certified public accountants in public practice at the

time of their election shall be nominated and elected by the Electors and may be Electors or other members of the AICPA. One of the elected Trustees qualified as a financial executive shall be nominated by the Financial Executives Institute and the other shall be nominated by the National Association of Accountants; the elected Trustee qualified as a financial analyst shall be nominated by the Financial Analysts Federation; and the elected Trustee qualified as an accounting educator shall be nominated by the American Accounting Association (such organizations and Trustees nominated by such organizations being hereinafter collectively and individually referred to as "nominating organizations" and "nominated Trustees"). The nominations of a nominating organization shall be in the form of a list of three or more nominees with a description of their qualifications and shall be submitted to the Electors no later than April 1 of the year in which the three-year term to which a nominated Trustee is to be elected commences. The Electors shall be the sole determiners of whether a nominee is suitable for election as Trustee. The Electors shall be entitled, but shall not be obligated, to assume that, in the selection and submission of its nominees, a nominating organization exercised reasonable diligence to ascertain that its nominees were suitable for election as Trustee. The Electors shall not unreasonably withhold the election of a Trustee from among the nominees submitted by a nominating organization, it being understood that the Electors' objective is to elect as a Trustee a suitable nominee who is acceptable to the nominating organization. Should the Electors determine that no nominee submitted by a nominating organization is suitable for election, they shall promptly so advise such nominating organization so that it may consult with the Electors concerning the suitability of the nominees submitted or submit additional nominees. Any other provision in this Section to the contrary notwithstanding, if the Electors, after consideration and consultation with a nominating organization, conclude that none of the nominees submitted by such organization is suitable for election as a Trustee, they may elect another individual as Trustee at a meeting of Electors held after July 1 and on or prior to the September 30 next preceding the commencement of his term; provided, however, that the composition of the Board of Trustees satisfies, in the judgment of the Electors, the criteria in Section 3 of this Article, except in the event of unfilled vacancies.

Section 5. *Vacancies.* Vacancies in the terms of elected Trustees may be filled by a majority of the Trustees then in office, though less

than a quorum, or by a sole remaining Trustee. Any Trustee so chosen shall be qualified, in the judgment of such Trustees or such sole remaining Trustee (as the case may be), from the same category of Trustee under Section 3 of this Article as the elected Trustee whose unexpired term he is filling, and such Trustee shall hold office for the balance of such unexpired term and until his successor is elected pursuant to Section 4 of this Article at a meeting of the Electors; provided, however, that if at a meeting of the Electors prior to the expiration of the balance of such unexpired term one or more nominations qualified from the foregoing category of Trustee under Section 3 of this Article, suitable to the Electors, are submitted for election as Trustee to serve for the balance of such unexpired term, the Electors shall elect a suitable nominee to serve the balance of such unexpired term (and until a successor is elected pursuant to Section 4 as aforesaid), upon which election such Trustee shall replace the Trustee previously elected by the Trustees for the balance of such unexpired term.

Section 6. *Committees.* The Board of Trustees may designate one or more committees, each committee to consist of one or more Trustees. The Board of Trustees may designate one or more other Trustees as alternate members of a committee who may replace any absent member at any meeting thereof. Any such committee, to the extent provided by the Board of Trustees and subject to the laws of the State of Delaware, shall have and may exercise any or all of the powers, authority and functions reserved to the Board of Trustees. Among such committees may be a committee whose responsibilities may include consideration of matters arising in respect of policies adopted by the Trustees pursuant to Section 4 of Article II-A of these By-Laws, including consultations with any member of the FASB in respect of whether such member should disqualify himself on a particular vote pursuant to Section 5 of Article II-A of these By-Laws.

Section 7. *Transition Rules.* Notwithstanding any other provision of this Article, the terms of the initial members of the Board of Trustees, other than the ex officio Trustee, shall expire as follows: two, including the term of one nominated Trustee, on September 30, 1973, three, including the term of two nominated Trustees, on September 30, 1974, and three, including the term of one nominated Trustee, on September 30, 1975 (and, in each case, until successors are elected). For purposes of determining eligibility for re-election as a Trustee, each of the foregoing initial terms expiring prior to September 30, 1975 shall not be deemed a "three-year term."

CHAPTER A | ARTICLE II-A

FINANCIAL ACCOUNTING STANDARDS BOARD

Section 1. *Financial Accounting Standards Board.* The Trustees shall appoint a board which shall be known as the Financial Accounting Standards Board. The FASB shall have and exercise all authority and power, and perform all functions, of the Foundation and the Board of Trustees in respect of standards of financial accounting and reporting, including the conduct of all activities related thereto.

Section 2. *Number and Qualifications of Members.* The number of members which shall constitute a full Financial Accounting Standards Board shall be seven, as follows: only four members shall be certified public accountants drawn from public practice or, in the judgment of the Trustees, principally experienced as public practitioners; and the remaining three members need not but may be certified public accountants and shall be persons who, in the judgment of the Trustees, are well versed in problems of financial reporting. Members of the FASB shall be remunerated at salaries to be determined by the Trustees, and shall serve full time.

Section 3. *Appointment of Members.* Except for the filling of vacancies for unexpired terms, each member of the FASB shall be appointed by the Trustees to a term expiring on September 30 in the fifth calendar year from the year of his election (and until his successor is appointed), and such term shall be staggered in such manner that the terms of not more than two members of the FASB shall expire on September 30 in any one year. No member of the FASB shall be appointed to a third consecutive full five-year term. Vacancies in unexpired terms of members of the FASB shall be filled as promptly as practicable by the Trustees. No member of the FASB shall be removed from office except on the vote of two-thirds of all Trustees serving and then only by reason of disability (which in the opinion of a physician selected by such Trustees will continue for a period of at least six consecutive months from the commencement of such disability), malfeasance or alleged malfeasance in office, or other cause deemed by such Trustees as reasonably evidencing conduct detrimental to the

purposes or repute of the FASB. Notwithstanding the foregoing, the initial appointments to the FASB shall expire as follows: one on September 30, 1974, two on September 30, 1975, one on September 30, 1976, two on September 30, 1977, and one on September 30, 1978 (and, in each case, until successors are appointed). For purposes of determining eligibility for reappointment as a member of the FASB, each of the foregoing initial terms expiring prior to September 30, 1977 shall not be deemed a "five-year term."

Section 4. *Outside Activities and Investments.* Appropriate policies shall be adopted, and from time to time may be altered, amended, supplemented and repealed, by the Trustees in respect of personal investments and other personal activities of members and the staff of the FASB. Such policies as shall be in effect at any time shall be designed and interpreted in such a manner as, in the judgment of the Trustees, will prevent conflicts of interest. No member of the FASB shall have any continuing proprietary, investment, economic or pecuniary relationship in, or association with, any firm, company, corporation or organization other than the Foundation, except as permitted pursuant to any such policy or with the specific permission of the Trustees.

Section 5. *Statements and Interpretations of the FASB; Voting; Quorum.* The FASB is hereby authorized to issue Statements of Financial Accounting Standards and Interpretations of Statements of Financial Accounting Standards, as hereinafter described in this Article. The rules of procedure prescribed by the FASB (or, as provided in Section 12 of this Article by the Trustees) shall set forth and provide for procedures with respect to the issuing of such Statements and Interpretations. The FASB's Statements and Interpretations shall relate to accounting for and presenting financial information.

The FASB shall not issue any Statement of Financial Accounting Standards or Interpretation of a Statement, or any exposure draft of any such Statement or Interpretation, without the approval of at least five of its members, except in the case of vacancy, disability of any duration or character preventing any member from voting, or in the event that any member, at any time prior to the vote, disqualifies himself from voting for reasons related to a policy of the Trustees adopted pursuant to Section 4 of this Article, in any of which events the approval of not less than four members of the FASB shall be sufficient. A member may vote even if he was not a member or otherwise was unable to or did not participate in any public hearings or otherwise

during the research, discussion or deliberative periods, and a member may continue to participate in public hearings and otherwise during the research, discussion and deliberative periods even though he has disqualified, or may disqualify, himself on a particular vote.

Except as otherwise expressly provided in this Section and in Section 12 of this Article, at all meetings of the FASB a majority of the members serving will constitute a quorum for the transaction of business, and the act of a majority of the members serving shall be required to approve any action.

Section 6. *Statements of Financial Accounting Standards.* The FASB's Statements of Financial Accounting Standards shall be designed to establish or improve standards of financial accounting and reporting for the guidance and education of the public, investors, creditors, preparers and suppliers of financial information, reporting entities and certified public accountants. The Chairman of the FASB shall provide for such research as he may deem necessary or desirable in the circumstances in connection with the preparation of Statements of Financial Accounting Standards or Interpretations of such Statements. Research may be conducted by the FASB's staff or by consultants or independent contractors appointed by its Chairman. The FASB's rules of procedure shall provide, in connection with the issuance of Statements of Financial Accounting Standards (other than in respect of any such Statement or Statements specifying that any or all, or any portions of the Accounting Research Bulletins of the Committee on Accounting Procedure, or any or all, or any portions of the Opinions of the Accounting Principles Board, of the AICPA should be considered as continuing in force), for the giving of notice and the holding of public hearings (except where in the judgment of the FASB on the basis of existing data it can make an informed decision without a public hearing), the exposure of proposed Statements of Financial Accounting Standards, and consultations in the discretion of the FASB with interested persons and organizations. Such rules shall further provide that transcripts of hearings, minutes of meetings of the FASB and, except where confidentiality is deemed advisable by the FASB, copies of documents submitted to the FASB by interested persons and organizations shall be publicly available.

Section 7. *Interpretations of Statements of Financial Accounting Standards.* Interpretations of Statements of Financial Accounting Standards, Interpretations of Accounting Research Bulletins of the Committee on Accounting Procedure of the AICPA and Interpretations

of Opinions of the Accounting Principles Board of the AICPA (all of which may be termed Interpretations of Statements of Financial Accounting Standards by the FASB and which from time to time are referred to collectively in these By-Laws as "Interpretations") may be issued by the FASB from time to time, in its discretion and with or without the appointment of task forces, research, notice, hearings or exposure, in clarification, explanation or elaboration of such Statements, Accounting Research Bulletins and Opinions as an aid to their understanding. Any proposed Interpretation shall be submitted for comment prior to issuance to the members of the Financial Accounting Standards Advisory Council for a period of not less than 15 days.

Section 8. *Other Communications.* The FASB may from time to time, in its discretion and with or without appointment of task forces, research, notice, hearings or exposure, issue in its name or at its direction other communications in respect of matters related to financial accounting and reporting, including its activities; provided, however, that such communications shall not purport to be Statements of Financial Accounting Standards or Interpretations.

Section 9. *Coordination With Other Organizations.* The FASB shall have the final and ultimate authority over the subject, style, content and substance of its Statements of Financial Accounting Standards, Interpretations and other communications. The FASB should at all times be mindful of the importance of clarity and persuasiveness in its Statements of Financial Accounting Standards, Interpretations and other communications, and of their impact on certified public accountants, the financial and business community and the public at large. Accordingly, the FASB shall endeavor to maintain continuing liaison with such interested persons and organizations as seek it.

Section 10. *Identification of Votes; Dissents.* Each Statement of Financial Accounting Standards and Interpretation shall identify those members of the FASB who voted for and against it, and shall include comments of dissenting members in support of their dissents.

Section 11. *Chairman of the Financial Accounting Standards Board.* The Trustees shall appoint, to serve at their pleasure, a member of the FASB as its Chairman and may also appoint one or more other members as Vice Chairmen to exercise the powers and to carry out the duties of the Chairman in his absence or disability. The Chairman of the FASB shall serve ex officio as Chairman of the Council.

The Chairman shall be the principal officer of the FASB and the Council, and shall preside at their meetings. The Chairman shall prepare the agenda of projects of the FASB and assign priorities thereto for submission to the FASB for approval. He shall prepare the annual budget of the FASB and the Council following consultation with other members of the FASB, and submit such budget to the Trustees for their approval. He shall also prepare an annual report with respect to the activities of the FASB and the Council and shall submit such report to the Trustees, the AICPA and the nominating organizations, which report shall constitute a portion of the public record of the FASB. He shall have authority to hire, retain and contract with staff members to serve the FASB or the Council, to fix their duties and the amount of their salaries and other compensation and to appoint and contract with any other persons or organizations with respect to research and other services to be performed by them as consultants or independent contractors. The Chairman also shall have authority to establish and appoint persons to task forces (who may but need not be members of the FASB or the Council) with the advice of other members of the FASB and, as he may deem appropriate, after consultation with members of the Council, and he may delegate or assign particular functions or duties to other members of the FASB, the staff of the FASB or the Council or others as he may determine. The Chairman shall be responsible for establishing operating and administrative procedures for task forces and the staffs of the FASB and the Council, and for implementing and directing the broad operating processes of the FASB and the Council. He may appoint an administrative director and a research director and shall designate a member of the staff of the FASB to serve as secretary and to keep a record of its proceedings. Staff members and members of task forces, and other persons and groups employed, hired or otherwise retained or appointed by or at the direction of the Chairman, shall serve at the pleasure of the Chairman or as otherwise provided in contracts made by or at his direction.

Section 12. *Rules of Procedure.* The initial rules of procedure of the FASB shall be adopted by the Trustees following public exposure for comment. Subject to the conditions specified in the By-Laws, the FASB shall thereafter have the exclusive authority to alter, amend, supplement, repeal and adopt rules of procedure, with or without notice, hearings or exposure, with the approval of at least five of its members, except in the case of vacancy, disability or disqualifica-

tion as provided in Section 5 of this Article, in any of which events the approval of four members of the FASB shall be sufficient.

CHAPTER A | ARTICLE III-A

FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL

Section 1. *Financial Accounting Standards Advisory Council.* The Trustees shall establish a council of not less than twenty persons who, in the judgment of the Trustees, shall be knowledgeable about the problems and impact of financial reporting or shall possess an expertise of value to the FASB, which council shall be known as the Financial Accounting Standards Advisory Council. Members of the Council shall be appointed for terms of one year expiring on September 30 in each year (except in the case of the terms of the initial members of the Council, which shall expire on September 30, 1974). Subject to the needs of the FASB, a member of the Council shall ordinarily serve no more than four consecutive terms, and the members of the Council shall broadly represent varied professional and occupational backgrounds with no profession or occupation predominating. Vacancies in unexpired terms may be filled by the Trustees as deemed desirable by them, and shall be filled whenever necessary to maintain the membership of the Council at twenty. Members of the Council shall serve without remuneration, but shall be reimbursed for such actual out-of-pocket expenses as they may request. Membership on the Council shall be personal to the persons appointed thereto and no member of the Council shall have any power of substitution or delegation of function as a Council member.

Section 2. *Functions of Members.* Upon the request of the Chairman, members of the Council shall consult with the Chairman or the FASB concerning the FASB's agenda of projects and the assigning of priorities thereto, matters likely to require the FASB's attention, the selection and organization of task forces and such other matters as may be requested. Upon request of the Chairman, members shall provide written comments in respect of Statements of Financial Accounting Standards and Interpretations proposed for issuance by the FASB. The

Council shall meet as often as deemed necessary by the Chairman, but generally not less than quarterly, and shall be advised by the Chairman of the FASB's activities and plans. The Chairman shall designate a person (who need not be a Council member) to serve as secretary of the Council and to keep a record of its proceedings. The Council shall not vote as a body and the Council and its members shall not be authorized to issue public communications. The minutes of meetings of the Council and written comments of members of the Council in respect of Statements of Financial Accounting Standards and Interpretations proposed for issuance shall constitute part of the public record of the FASB.

CHAPTER A | ARTICLE IV-A

AMENDMENTS TO CHAPTER A AND ARTICLE III-B OF CHAPTER B

Chapter A and Article III-B of Chapter B of these By-Laws may be altered, amended, supplemented or repealed by the affirmative vote of eight Trustees at any regular or special meeting of the Trustees for which notice of such alteration, amendment, supplement or repeal is contained in the notice of such meeting. In the case of any conflict between any provision of Chapter A or Article III-B of Chapter B of these By-Laws with any other provision of Chapter B of these By-Laws, the provisions contained in Chapter A and Article III-B of Chapter B shall prevail.

CHAPTER B | ARTICLE I-B

OFFICES

Section 1. *Registered Office.* The location of the registered office of the registered agent of the Foundation in the State of Delaware shall be as determined from time to time by the Board of Trustees, in accordance with the laws of the State of Delaware. The initial regis-

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tered office of the Foundation is at No. 100 West Tenth Street, in the City of Wilmington, County of New Castle, State of Delaware. The initial registered agent of the Foundation at such address is The Corporation Trust Company.

Section 2. *Other Offices.* The principal office or offices of the Foundation and the FASB shall be determined by the Trustees. The Foundation and the FASB may also each have offices at such other places both within and without the State of Delaware as the Board of Trustees may from time to time determine.

CHAPTER B | ARTICLE II-B

MEETINGS OF TRUSTEES

Section 1. *Meetings Generally.* The Trustees may hold regular and special meetings either within or without the State of Delaware. Minutes of meetings of the Trustees, and written consents in lieu of any meeting, shall constitute a portion of the public record of the Foundation.

Section 2. *Regular Meetings.* Regular meetings of the Trustees may be held without notice at such time and place as shall from time to time be determined by the Trustees.

Section 3. *Special Meetings.* Special meetings of the Trustees may be called by the President on at least 72 hours notice to each Trustee. Special meetings shall be called by the President on like notice at the written request of a majority of the Trustees then serving.

Section 4. *Quorum; Adjourned Meetings.* At all meetings of the Trustees, six Trustees shall constitute a quorum for the transaction of business, and the act of six Trustees at any meeting shall be required to approve any action, except as may be otherwise specifically provided by statute or by the Certificate of Incorporation or these By-Laws. If a quorum shall not be present at any meeting of the Trustees, the Trustees present may adjourn the meeting from time to time without

notice other than announcement at the meeting until a quorum shall be present.

Section 5. *Action Without Meeting.* Unless otherwise required by statute, any action required or permitted to be taken at any meeting of the Trustees may be taken without a meeting, if all Trustees consent thereto in writing and such writing or writings are filed with the minutes of proceedings of the Trustees.

CHAPTER B | ARTICLE III-B

MEETINGS OF ELECTORS

The Electors may hold their meetings either within or without the State of Delaware. The Electors shall hold at least one meeting after July 1 and on or prior to September 30 of each year (commencing in 1973) on such date and at such time and place as shall be specified in the notice of such meeting or in the notice of any meeting of the Board of Directors of the AICPA held during such period. Other meetings of the Electors may be held from time to time on such dates and at such times and places as shall be specified in the notice of any such meeting or in the notice of any meeting of the Board of Directors of the AICPA, and shall be so called by the ex officio Trustee or at his direction on the written request of five or more Electors. Notice of any meeting of Electors shall be given to Electors not less than ten days prior to the date of such meeting. In the case of any election of Trustees, a majority of the Electors serving, and in the case of any removal of a Trustee, two-thirds of the Electors serving, present or represented by proxy at any such meeting, shall constitute a quorum for the transaction of business. If a quorum as to any such business shall not be present or represented by proxy at any meeting of Electors, the Electors present or so represented may transact such business as to which there shall be a quorum and adjourn the meeting from time to time without notice other than announcement at the meeting as to any other business until a quorum shall be present. Unless otherwise required by statute, any action required or permitted to be taken at any meeting of the Electors may be taken without a meeting, if all Electors consent thereto in writing and such writing or writings are filed with the minutes of proceedings of the Electors.

CHAPTER B | ARTICLE IV-B

NOTICES

Section 1. *Generally.* Whenever notice is required to be given to any person, personal notice shall not be required, and notice may be given in writing, by mail or by telegram, addressed to such person at his address as it appears on the records of the Foundation, with postage or charges prepaid, and such notice shall be deemed to be given at the time when the same shall be deposited in the United States mail or at the telegraph office as the case may be. Notice to any person may also be given by telephone or in person and such notice shall be deemed to be given at the time when the same shall actually be communicated to such person.

Section 2. *Waiver.* Whenever any notice is required to be given to any person, a waiver thereof in writing, signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent thereto. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when such person attends a meeting for the express purpose of objecting at the beginning of the meeting to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any meeting need be specified in any written waiver of notice unless otherwise specifically provided by statute, the Certificate of Incorporation or these By-Laws.

CHAPTER B | ARTICLE V-B

OFFICERS AND STAFF

Section 1. *Principal Officers of the Foundation.* The principal officers of the Foundation shall be the President (who shall be ex officio the Chairman of the Board of Trustees), one or more Vice-Presidents, a Secretary and a Treasurer. Any number of offices may be held by the same person, except for the offices of President and Secretary and President and Vice-President. Such principal officers

shall be elected by and from among the Trustees, and shall serve at the pleasure of the Board of Trustees.

Section 2. *Selection of Other Officers of the Foundation.* The Trustees may appoint one or more persons to serve as an Assistant Secretary and/or an Assistant Treasurer and to exercise the powers and carry out the duties of the Secretary or the Treasurer, respectively, in their absence or disability or under their direction. Such officers may but need not be appointed from among the Trustees, and shall serve at the pleasure of the Board of Trustees.

Section 3. *President and Vice-President.* The President shall be the principal officer of the Foundation and the Board of Trustees with all such powers and duties as normally pertain to such office and shall preside at all meetings of the Trustees. The Trustees shall designate a Vice-President to exercise the powers and carry out the duties of the President in his absence or disability or under his direction.

Section 4. *Secretary.* The Secretary shall have responsibility for recording the proceedings of the Board of Trustees in a book to be kept for that purpose. The Secretary shall give, or cause to be given, notice of all meetings of the Trustees for which notice is required, and shall perform such other duties as may be prescribed by the Trustees or the President. He shall have custody of the corporate seal of the Foundation and shall have authority to affix the same to any instrument requiring it and, when so affixed, it may be attested by his signature. The Trustees may give general authority to any other officer to affix the seal of the Foundation and to attest such affixing by his signature.

Section 5. *Treasurer.* The Treasurer shall have responsibility for the custody of the Foundation's funds and securities, the maintenance of the Foundation's books of account and the deposit of moneys and other valuable effects in the name and to the credit of the Foundation in such depositories as may be designated by the Board of Trustees or the President. The Treasurer shall be responsible for disbursing the funds of the Foundation, and shall render to the President and to the Trustees at their regular meetings (or otherwise when they so require) accounts of the results of operations and financial position of the Foundation.

Section 6. *Execution of Documents.* All deeds, mortgages, bonds, contracts, reports and other instruments may be executed in behalf of the Foundation by the President or by any other individual authorized to take such action, whether by statute, the Certificate of Incorporation, these By-Laws or a general or specific authorization of the Trustees, including the Chairman of the Financial Accounting Standards Board and members of its staff so authorized by him with the concurrence of the Trustees.

Section 7. *Reports.* The President of the Board of Trustees shall report annually to the American Institute of Certified Public Accountants and nominating organizations with respect to the activities of the Foundation, which report shall constitute part of the public record of the Foundation.

CHAPTER B | ARTICLE VI-B

GENERAL PROVISIONS

Section 1. *Checks.* All checks or demands for money and notes of the Foundation shall be signed by such officer or officers or such other person or persons as the Board of Trustees or the President (with the concurrence of the Trustees) may from time to time designate.

Section 2. *Fiscal Year.* The fiscal year of the Foundation begins on the first day of June and ends the thirty-first day of the following May.

Section 3. *Seal.* The corporate seal shall have inscribed thereon the name of the Foundation, the year of its organization and the words "Corporate Seal, Delaware." The seal may be used by causing it or a facsimile thereof to be impressed, affixed or otherwise reproduced.

Section 4. *Indemnification.* The Foundation shall indemnify to the full extent authorized by the laws of the State of Delaware any person made or threatened to be made a party to any action, suit or proceeding, whether criminal, civil, administrative or investigative, by reason of the fact that he, his testator or intestate is or was a member, Trustee, officer, employee or agent of the Foundation or serves or served any other enterprise as a director, trustee, officer, employee or agent at the request of the Foundation. For purposes of this Section

4, the Foundation shall include the Financial Accounting Standards Board and the Financial Accounting Standards Advisory Council, and the members, officers, employees and agents of the FASB and the Council, including task forces, shall be deemed officers, employees or agents, as the case may be, of the Foundation.

Without limiting the generality of the foregoing, the Foundation may contract for insurance against all or a portion of any liabilities and expenses, if any, resulting from the indemnification of any of the foregoing persons pursuant to this Section 4 or otherwise as permitted by the laws of the State of Delaware, and may also contract for companion insurance directly insuring any or all of such persons against liabilities and expenses.

CHAPTER B | ARTICLE VII-B

FINANCES

Section 1. *Funds.* The funds necessary to conduct the business of the Foundation shall be solicited and provided through contributions, grants or as otherwise determined by the Trustees, subject always, however, to Articles Third and Eighth of the Certificate of Incorporation.

Section 2. *Audit.* The Trustees shall, for each fiscal year, appoint a certified public accountant or certified public accountants to express an opinion on the financial statements of the Foundation and its affiliates, if any, and such financial statements and the report of the independent auditor or auditors thereon shall be submitted annually to the Trustees, the AICPA and the nominating organizations, which financial statements and report shall constitute part of the public record of the Foundation.

CHAPTER B | ARTICLE VIII-B

INTERESTED TRUSTEES OR OFFICERS

Provided that the Corporation shall at all times and in all respects be operated in a manner consistent with Articles Third and Eighth

of the Certificate of Incorporation, no contract or transaction between the Foundation and one or more of its Trustees or officers, or between the Foundation and any other corporation, partnership, association or other organization in which one or more of its Trustees or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the Trustee or officer is present at or participates in the meeting which authorizes the contract or transaction, or solely because his or their votes are counted for such purpose, if:

(a) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the Trustees and such Trustees in good faith authorize the contract or transaction by the affirmative votes of a majority of the disinterested Trustees, even though such disinterested Trustees be less than a quorum; or

(b) The contract or transaction is fair as to the Foundation as of the time it is authorized, approved or ratified, by the Trustees.

Common or interested Trustees may be counted in determining the presence of a quorum at a meeting of the Trustees which authorized the contract or transaction.

CHAPTER B | ARTICLE IX-B

AMENDMENTS TO CHAPTER B (OTHER THAN ARTICLE III-B)

Chapter B (other than Article III-B) of these By-Laws may be altered, amended, supplemented or repealed by the affirmative vote of six Trustees at any regular or special meeting of the Trustees for which notice of such alteration, amendment, supplement or repeal is contained in the notice or such meeting.

Appendix E
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FINANCIAL ACCOUNTING FOUNDATION/FINANCIAL ACCOUNTING STANDARDS BOARD

Members of the Financial Accounting
Standards Advisory Council
As of May 15, 1976

Name	Affiliation
Marshall S. Armstrong	Financial Accounting Standards Board
Andrew Barr	Retired
Norton M. Bedford	Professor of Accountancy, University of Illinois
William E. Buxbaum	E. I. du Pont de Nemours & Co.
George R. Catlett	Arthur Andersen & Co.
Joseph P. Cummings	Peat, Marwick, Mitchell & Co.
J. O. Edwards	Exxon Company, U. S. A.
Frank Forester, Jr.	Morgan Guaranty Trust Company of New York
Charles G. Gillette	Arthur Young & Company
John A. Grady	Interstate Commerce Commission
Charles C. Hornbostel	Financial Executives Institute
Charles T. Horngren	Professor, Stanford University
Allan Kramer	Shea Gould Climenko Kramer & Casey
Harold Q. Langenderfer	Professor of Professional Accounting, University of North Carolina
Raymond C. Lauver	Price Waterhouse & Co.
Robert A. Malin	The First Boston Corporation
Robert K. Mautz	Ernst & Ernst
Charles T. McGarraugh	Northwest Bancorporation
Robert A. Morgan	Caterpillar Tractor Co.
James W. Nethercott	The Procter & Gamble Company

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Name	Affiliation
William C. Norby	Duff and Phelps, Inc.
David Norr	First Manhattan Co.
Richard C. O'Sullivan	Monsanto Company
Elmer B. Staats	United States General Accounting Office
Frances G. Stone	Merrill Lynch, Pierce, Fenner & Smith, Inc.
E. Palmer Tang	Touche Ross & Co.
Robert C. Thompson	Shell Oil Company
Allan Wear	Ford Motor Company
Charles A. Werner	Alexander Grant & Company
Francis M. Wheat	Gibson, Dunn & Crutcher
John C. Whitehead	Goldman Sachs & Co.
John A. Willis	Union Carbide Corporation

(Staff Note: This is the end of the exhibits submitted by FASB.)

(From the Wall Street Journal, October 6, 1975.)

Accountants to Tackle Oil and Gas Standards To Head Off Congress

By a WALL STREET JOURNAL *Staff Reporter*

NEW YORK—The Financial Accounting Standards Board moved to take up the thorny topic of oil-and-gas accounting before Congress decides to give the job to someone else.

The standards board's new project was prompted by the massive energy bill passed last month by the House of Representatives. As part of building an "energy data base," the House version of the legislation would require the Securities and Exchange Commission to adopt rules setting uniform accounting practices for oil-and-gas concerns. The SEC would have 21 months for the task and would be instructed to consult with the standards board.

Both the standards board and the SEC oppose the proposal as contrary to the regulatory agency's policy of generally relying on the accounting profession to set accounting practices, under SEC oversight. The SEC has explicitly endorsed the standards board as the private sector's top authority on accounting matters. It's feared that relegating the board to a secondary role in oil-and-gas accounting would be a severe blow to its credibility. In addition, 21 months isn't considered enough time.

The House bill's mandate to the SEC isn't its only provision causing a storm in accounting circles. The bill would also empower the General Accounting Office to make "oversight audits" of public accounting firms that audit integrated petroleum companies, including broad authority to examine the audit firms' books and records. If a firm's audit work were deemed inadequate, the GAO would be authorized to do the audit itself.

The SEC has called this proposal "highly undesirable," and it is strongly opposed by the American Institute of Certified Public Accountants.

In an interview, Marshall S. Armstrong, the standards-board chairman, said the board hoped to persuade the House-Senate conference committee on the energy bill simply to give the SEC broad responsibility for ensuring that uniform oil-and-gas accounting practices are adopted, without requiring the agency, itself, to issue rules. The board also hopes to convince the committee that three years is a reasonable deadline, Mr. Armstrong said.

The conference committee is scheduled to begin its deliberations this week.

Oil-and-gas accounting has been waiting in the wings since the standards board set its original agenda in 1973. Its predecessor, the Accounting Principles Board, had struggled unsuccessfully with the problem in its final months, and the standards board decided it wouldn't take up the controversial accounting tangle immediately. Oil and gas accounting combines difficult technical questions with entrenched positions by different industry segments on favorite accounting methods.

The most fundamental division concerns how to account for "dry-hole" costs, or the cost of exploration and drilling that prove unsuccessful. The industry's largest and older companies generally charge off these outlays immediately. By contrast, the newer and smaller "independent" producers usually follow the "full-cost" accounting method, which provides for "capitalizing" such costs and charging them off gradually against future revenue from oil production.

The project announced Friday by the standards board will apply generally to extractive industries, but mainly to oil and gas. It will cover accounting and disclosure rules for exploration, acquisition of mineral properties, and development and production of reserves.

A basic issue is when, if ever, "intangible" costs should be capitalized or deferred; and if deferred, what system should be followed in gradually charging such costs to earnings. ("Intangible" costs are a broad category ranging from expenditures on geological surveys to outlays for labor, fuel, power and equipment rentals in drilling operations.) The standards board will also consider how to associate particular costs with particular reserves. Another important question is how much data about reserves oil-and-gas producers should be required to disclose in their financial statements.

THE POLITICS OF ESTABLISHING ACCOUNTING STANDARDS

An Address
By

MARSHALL S. ARMSTRONG
Chairman of the
FINANCIAL ACCOUNTING STANDARDS BOARD

Before The

THIRD ANNUAL
SECURITIES REGULATION INSTITUTE

San Diego, California

January 16, 1976

Good afternoon, ladies and gentlemen. I am truly honored to have been asked to appear among the prominent gentlemen whom you have heard speak this morning and from whom you will hear this afternoon; for these, representing the accounting profession, government, academe and the law, are among the foremost men in this country, and the matters which they have been discussing with you are the leading accounting problems of the day.

I should like to speak today on politics -- the politics of establishing financial accounting standards. And I shall particularly speak on a few of the problems which we, the Financial Accounting Standards Board, are encountering. Finally, I shall discuss with you where I believe political activity is likely to lead, if it continues as it has in the past.

As we solicit views through our discussion memoranda and exposure drafts, we hear from many. A few, like the large public accounting firms and some business enterprises, are, for the most part, interested in achieving standards that will eliminate alternative practices, standards that will find their support in the broad, conceptual bases of accounting. Their responses reflect this, and while their views are diverse, their reasoning is generally quite lucid. And others -- many others -- respond

from a vested interest in diversity of practice, from a firm commitment to flexibility of measurement.

These latter reason awkwardly, for their motives -- though frequently well concealed -- lack purity, lack objectivity. In reflecting upon the views that we hear expressed by our public, I am reminded of the words of Edmund Burke, from Reflections on the Revolution in France. He said:

> Because half-a-dozen grasshoppers under a fern make the field ring with their important chink, whilst thousands of great cattle repose beneath the shadow of the British oak, chew the cud and are silent, pray do not imagine that those who make the noise are the only inhabitants of the field;....

I am inclined to Burke's view; for in many of the problems with which we at the Board are dealing, we are faced with a small but vocal minority, whose primary concern appears not to be with the development of sound standards, but rather with the protection of their own domains. And, we must constantly remind ourselves of this, lest we lose an awareness that this is the environment in which we are operating.

Before moving to the subject of my concern, the politics of this business, I should like to spend a moment reflecting with you on the history of establishing accounting standards in this country -- for I feel that those who have not looked back to their predecessors shall be forever unable to look forward to posterity.

While great concern about financial accounting standards was expressed by many during the excessive years of the twenties, little of a constructive nature was undertaken prior to the adoption, in 1934, of six rules by the membership of the then American Institute of Accountants. The rules were straightforward -- designed to correct abuses which would shock even the most creative of accountants today.

In 1939, the Committee on Accounting Procedure came into being, and over its twenty-year life issued more than fifty pronouncements. These pronouncements dealt with many issues, troublesome to the profession -- but the primary thrust was to financial statement content and format, and to certain aspects of disclosure. Of the total of fifty-one Accounting Research Bulletins, it is worth noting that only nineteen might be considered as having dealt with measurement -- accounting principles that affected financial position and the results of operations. The Committee had neither the power nor the authority to enforce its views, and seems, consequently, to have been little concerned with standardization of measurement. The early hope that the Committee would be able to reduce alternatives in financial accounting was to be realized only in small part.

Nevertheless, this group was subjected to some very substantial challenges during its twenty-year tenure. During the late 1950s the group was under constant attack by a spokesman for one of the major accounting firms who contended that it was not doing its job, and that, in the context of that time, it could not.

It was challenged by legal action, when three subsidiaries of American Electric Power Company, the Nation's largest electric power holding company, sought an injunction against the issuance of clarification to Bulletin No. 44. Fortunately, the plaintiff lost in the Federal District Court and again on appeal to the Second Circuit. That Court said, "...we think the Courts may not dictate or control the procedures by which a private organization expresses its honestly held views." Certiorari was denied by the Supreme Court.

In 1959, with the creation of the Accounting Principles Board, came a more formidable organization. The original Board was comprised of the managing partners of each of the major accounting firms in the country, as well as a select group from other influential niches in the business and academic communities. With such commending representation from the profession, there was every hope that the new Board would be more effective in enforcing its pronouncements and in achieving significant reduction in diversity of practice.

The political history of the APB, as I am sure you recall, began with the issuance of its second Opinion, that dealing with the investment tax credit. I am reluctant to rehash that situation, for I am confident that everyone in this room remembers well the fiasco that resulted: a number of the major accounting firms flatly refused to enforce the Opinion. Sufficient pressure was ultimately put on the Legislature to change the tax law, and upon the SEC to withdraw support, effectively nullifying the Opinion. Two years after its issuance, and as a direct consequence of this pressure, the Board relented, and modified its earlier decision.

Interestingly, even though there was a firmly held conviction that the original decision was the correct one, the Board was never able to enforce it. The opportunity was lost in an environment of blatant politics. The tax credit lapsed, and upon reenactment by Congress, a specification was included that prohibited any group from prescribing accounting for the credit. This was the obvious product of a major lobbying effort.

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A not dissimilar controversy began brewing in the late 60s, as financial writers recognized that the criteria for distinguishing between "purchases" and "poolings" had all but disappeared. Again, I might add, this occurred with the tacet agreement of the Securities and Exchange Commission. The APB placed the question on its agenda and strove admirably to obtain the two-thirds majority necessary to repair this decimated area of accounting; but it was possible to obtain the requisite consensus only by separating the business combination question from the goodwill controversy, and the result was two "cookbook" solutions, Opinions 16 and 17. The SEC, which had vacillated on the issue, finally accepted the Board's conclusions; and the major stock exchanges wrote letters to each of their listed companies urging support of these Opinions. These two Opinions -- the "cut and paste" product of one of the great political wars of American accounting -- had, in the view of many, more to do with the demise of the APB than any other action which it took. Not surprisingly, while the Opinions have been helpful, the solutions have not stood up; and the issues are again before us and are on the agenda of the FASB.

In 1970, at the behest of three of the major accounting firms, a meeting was called by the Board of Directors of the AICPA to discuss the operations of the APB and how they might be made more effective. There were those who felt that the fault lay with methodology. All were concerned with the apparent

failure of the APB to achieve consensus, and with the excruciating political pressures to which many of its members were being subjected. This meeting resulted in two study committees being created -- the Wheat and Trueblood Committees -- and, as you know, the Wheat Committee developed the germs from which the Financial Accounting Standards Board ultimately evolved.

And, here, I believe it is important to note that one of the features contributing most significantly to the demise of the APB was the political pressure to which the members of that Board were subjected. Its reorganization into the present format, the FASB, was intended to create a broadly-based, responsive organization which would not be susceptible to political pressure. And, that brings us to the problems of today, for the pressures are more complex and more subtle than envisioned at that time.

At the time of the formation of the Financial Accounting Standards Board, there was, I believe, general consensus that an organization of this nature, independently funded and separated from the pressures of the profession, staffed by competent accounting thinkers, could do the job.

It seems only yesterday that Reginald Jones, Chairman of the Board of General Electric, introduced the new Board at a dinner in New York. The air was charged with hope and expectation as,

speaking of bridging the chasm lying between the American people's high expectations of business and their low evaluation of its perceived accomplishments, he said:

> I believe we can build such a bridge. The very reason we are assembled here tonight -- to launch the Financial Accounting Standards Board -- is an indication of our willingness to tackle the assignment. For improving the credibility of financial reporting is virtually a *sine qua non* for effectively communicating with the public.

But is it working as Mr. Jones, and as, in fact, all of us, had hoped in those early days? While I believe it is working well -- I sense mounting criticism from members of the profession, the business community, and now even the financial press. And, we are hearing dissatisfaction expressed by members of the Legislature, who have been contacted by a complaining constituency.

In an address last Fall, that was subsequently widely published, the Board and I, as Chairman, were sharply criticized by the chief executive of one of the major accounting firms, who contended that we were not providing the leadership needed to bring about change -- rapid change -- that business and the profession both required.

On the other hand, our Vice Chairman encountered rather sharp, but different, criticism when he spoke recently to a top-drawer group of financial executives. That group seemed to feel the Board was moving too fast, was not responsive to the needs of business, and was, in fact, ignoring input from the business community.

I should add, at this point -- the SEC and other government agencies are doing everything possible to support this new venture. The record is clear that the FASB has an excellent working relationship with the SEC and the CASB -- in fact, we have the best and most supportive relationship that has existed during the past forty years between the SEC and the private sector's standard-setting body.

What then is the real problem? Is support for the Board waning? And, why are those high expectations of three years ago not being fully met today?

In my view, it is because accounting, like law, is an art whose rules are not susceptible to pragmatic tests of validity, such as those available to the physical sciences. Accounting is rather a convention supported only by general acceptance, consensus, and verifiable against no immutable standard or natural law. Absent such validating tests there must be many views of equal authority, for perceptions among individuals vary widely; so broad, in fact, is this diversity in perception that, in my view, true consensus is impossible.

Let me point this up for you. In our first discussion memorandum on the Conceptual Framework of Accounting we sought an expression of opinion from respondents on the following as a basic objective of financial statements; it is taken directly from the Trueblood Report:

> The basic objective of financial statements is to provide information useful for making economic decisions.

Could there be disagreement with a statement such as this? I am sure you will be astounded when I tell you that only thirty-seven percent of our respondents were able to recommend the adoption of this objective. Thirty-seven percent! Twenty-two percent recommended that it be rejected out-of-hand; and ten percent insisted that it needed further study. Can you conceive of that? Only thirty-seven percent can agree that the basic objective of financial statements is to provide information useful for making economic decisions. I think this suggests the problem quite clearly.

Those who disagreed with this tenet generally took the position that the basic function of financial statements was to report on managements' stewardship of corporate assets -- and that the informational needs of readers was of secondary importance.

It follows from this line of thinking that management can best determine the principles to be employed in reporting on their firms, and that standards -- standards almost of any sort -- can only impede management in its effort to fulfill this responsibility. It seems fair to say, management has a vested interest in diversity of accounting standards, for diversity means flexibility, and flexibility opens up options often as diverse as operational choices.

And, as we approach standards confronting vested interests in flexible accounting options, we are beginning to sense political action -- political action designed to retain these choices.

The difficulty as I see it, is that without a significant reduction in the accounting options available to enterprises we will have failed in our principal objective -- the narrowing of accepted accounting alternatives. And this, in my view, can be achieved only through a consensus which requires that many -- and I mean <u>many</u> -- must surrender options for the good of the entire financial community. Bob Mautz, a member of the Cost Accounting Standards Board and of our Advisory Council, has said that the establishment of accounting standards is like a tax, in that it takes from some for the benefit of all.

A similar view is reflected in the current issue of Business Week; the authors, two academics, point out that accounting is not neutral, that accounting choices involve social choices. From this they reason -- and quite accurately, it seems to me -- that we should extend our research into macro-economic consequences of accounting policy, and that economic effects should be more clearly understood by all in connection with the decision process.

This is the situation; these are the facts.

Yet, without consensus -- and by consensus, in this case, I do not mean agreement but rather the absence of active political disagreement -- this effort can neither achieve its goals nor survive.

In my judgment, the financial community must band together and support the FASB with a clear recognition of the consequences of failure. This effort will succeed if, and only if, the entire financial community recognizes clearly that they must voluntarily submit to and support issued standards -- even when those standards jeopardize traditional management prerogative, and must restrict political action to the avenues provided by the procedures of the Board. Employment of other channels must ultimately result in the increased participation of government agencies, and perhaps the Legislature, and that, in my view, will spell the demise of this effort.

Let me tell you of a few of our recent experiences -- of the politics and divergent views which we encountered -- and perhaps even suggest to you areas where political action is likely to be forthcoming in the near future.

In March of last year, we issued Statement No. 5, Accounting for Contingencies. One of the principal issues resolved by this Statement was whether a casualty insurance company could record catastrophe reserves, predicated upon some unidentified future catastrophe. We concluded that an accrual was not appropriate unless a reasonable estimate of the loss could be made, and until it is probable that an asset has been impaired or a liability incurred, and the effect is measurable. Shortly after we issued that Statement, I received a letter from a prominent member of the Legislature asking the basis on which we had arrived at this conclusion. He expressed concern, in behalf of some constituents, that we had acted with cavalier disregard to the fact that this Statement would wreck the American insurance industry, could result in an adverse balance of foreign exchange, spelling potential disaster for the American economy. We were able to satisfy this Senator that we had not issued this Statement recklessly and that our purpose lacked the sinister character that had obviously been attributed. However, I can't help but wonder about the recklessness of those who go to the Legislature with problems such as this. Is their concern with the quality of American accounting? What do they imagine will be the reaction of a Legislature presented with horror stories such as this?

We presently have on our agenda a project on Accounting for Changes in General Purchasing Power. It's interesting to see how the powers line up on this issue. Of the large accounting firms, none of whom have a vested interest in the outcome, opinion is diverse: four favor the proposal, three are against it, and two suggest that action be deferred.

Banks and insurance companies, on the other hand, have no such diversity in view. They are absolutely and unequivocally opposed because of the impact that this proposal would have on their earnings: it would tend to reduce them. While they may discuss the issue on conceptual grounds, they arrive at one conclusion -- the pragmatic one.

On the other hand, public utilities and transportation companies, who will experience an increase in their earnings should the proposal be adopted in its present form, are also virtually solidly opposed to it. But, note the effect is different; here, earnings are increased. This group either favored the concept of price-level adjustments for only depreciation and similar costs -- and raged against the recognition of gain on long-term liabilities, or insisted that fixed assets, in their case, should be treated as monetary items. They presented a new set of arguments, but their motivation was equally pragmatic.

We are encountering another power block in connection with this project: small public accounting firms argue that the proposal might increase the amount of work which they do for their clients or, if not done, would require that they qualify their opinions on these reports. These accounting firms have undertaken a vigorous write-in campaign to apprise us of the disastrous consequences of this proposal. What is their real concern? Although their arguments are couched in language questioning the usefulness of price-level data and concern over the cost of providing it -- the true motivation for the spectacular response we have received may be the concern, expressed by only a few, that with increased costs their clients may drift to other practitioners not required to insist on compliance with this standard. Is this how accounting principles should be forged?

Last month we issued Standard No. 12 dealing with Accounting for Certain Marketable Equity Securities. This project has an interesting background, described by Maurice Moonitz in his monograph, Attaining Agreement on Standards. The APB undertook an intensive consideration of the subject of marketable securities in the Fall of 1968, in an effect to establish how securities should be valued and how changes in value should be reflected in financial statements. In May 1971, the APB sponsored a two-day public hearing, and in the months following narrowed its preferences. In the Fall of that year a committee draft was circulated which favored recognizing changes in market value in the

income statement. The insurance industry virtually "blitzkrieged" the Government, and the SEC finally told the Board that it could not support the method chosen. The APB then shifted its choice to a "spreading approach," which met with strong resistance from the casualty insurance companies. At this point, the SEC advised the Board that it could not support an approach so vehemently opposed by industry. Again, the APB revised its approach and again it was opposed by the SEC. This potato was just too hot to handle; the pressures were too great, and the project was abandoned.

Last Fall, we undertook a similar but more constricted project on a "short-fuse" basis; we intended to limit its scope to marketable equity securities and put the matter to rest with dispatch. We were faced with a very significant write-in campaign from one industry group who strongly felt they should be exempted from the standard. We also heard from Government regulators concerned over the impact the standard could have on that industry. We heard from a number of companies who were just basically opposed to losing control over the realization or non-realization of security gains and losses, by a method which measured these gains and losses not on sale but a change in market price -- a method that robbed management of some of its income realization prerogatives. We heard from the purists, but we heard far more from the pragmatists; and, I do not believe we have heard the end of this problem.

Our standard is now published and in my view it reduces the diversity in accounting. This, I feel, is our primary role. But let us watch to see what further action -- action of a political nature -- is taken by those who oppose this standard.

In conclusion, ladies and gentlemen, I have attempted to suggest to you today the highly political nature of establishing accounting standards and I have told you of some of the specific politics involved. These are matters of public record: one need only read Zeff, Moonitz, and the other writers on the APB; and, all that I have told you is also quite apparent from the public record of responses received by the FASB.

For the most part, the accounting profession and a few business enterprises seek clear, conceptual answers that will resolve technical problems, reduce diversity in accounting, and will eliminate the practice that we have come to know as "shopping for accounting principles."

American business, on the other hand, while not totally negative with respect to properly based conceptual answers, is too often more concerned over the impact of their own financial statements, and has a strong resistance to any accounting changes reaching back to earlier years, altering in their judgment the credibility of issued financial statements.

We hear from the accounting firms, and for the most part, we hear from them on each issue we raise. Business, on the other hand, with a few notable exceptions, responds only when a proposal could have an adverse effect on its own financial statements. Thus, the picture which we see from business is frequently strongly biased.

In the address which I mentioned earlier, Reginald Jones anticipated these problems. He said:

> We must recognize the new Board will not be a cure-all for every ailment. We must recognize that with its first decision, the new Board is going to gore somebody's ox -- and that will be the time for us to pull together -- not to splinter apart.
>
> Let's not lose sight -- he said -- of the public and professional momentum that has brought us this far; and let's not forget that if we falter, government stands ready to do for us what we can't do for ourselves.

American business has long had an image of being conservative, of resisting rapid change, and in some cases of being opposed to progress in accounting. American business has also been highly respected for its ability to get things done: for having the know-how, for having the energy, and for having the drive to accomplish virtual impossibilities. What other country in the world would enter into a naval war, as we did in 1941, when its navy had just been sunk. We did that on the strength -- the great strength -- of American business, and its ability to get things done.

Here is an opportunity once and for all for American business to demonstrate its interest in improved financial communication and its willingness to subordinate self-interest to the public good. Here is an opportunity for once and for all for American business to demonstrate its willingness to change the status quo.

As this Board progresses in its efforts, it is likely that we will find increasing political pressure by those whose "oxen are gored." Then, as they go to Washington seeking to stop our efforts, seeking to protect self-interest, we will need your support. You must also go and explain to our Legislators and to Government agencies that in order to narrow the gap in financial accounting it is necessary that change be made, and that each change will trouble some; but that change, on the whole, is

improvement, and that improvement is the objective of each of us. Each of you, and all of you, must help us to prevent politics from sinking this great endeavor. Each of you must speak out for the common good.

# # # #

(From the Wall Street Journal, April 16, 1976.)

Accounting Standards Board Member Quits

By a WALL STREET JOURNAL *Staff Reporter*

STAMFORD, Conn. — Walter Schuetze, one of the original seven members of the Financial Accounting Standards Board, resigned, effective June 30, to return to the accounting firm of Peat, Marwick, Mitchell & Co.

"I just decided for personal reasons to make a move," Mr. Schuetze said in an interview. "It has nothing to do with the board. I am very pleased with the board," he added.

Mr. Schuetze, 43 years old, was named to the standards board three years ago as one of two younger members. His initial term would have expired in September 1978.

In announcing his resignation, the standards board also announced that the other younger member, Donald J. Kirk, also 43, is being reappointed to a five-year term expiring in September 1981. He and Mr. Schuetze have served as co-chairmen of the board's screening committee on emerging problems. Mr. Kirk will continue to head that committee.

Walter E. Hanson, Peat Marwick senior partner, said Mr. Schuetze would be given a top-level job in the firm's department of professional practice. Mr. Schuetze declined to say what his compensation at Peat Marwick would be. Standards board members are paid $115,000 a year.

STATUS REPORT

Financial Accounting Standards Board

No. 36 April 28, 1976

Kirk Accepts Re-appointment to Board; Schuetze Plans to Return to Public Accounting Practice

Donald J. Kirk, a member of the Financial Accounting Standards Board since its inception in 1973, has accepted re-appointment for an additional five-year term. His original appointment expires September 30, 1976. In a concurrent development, Walter Schuetze, also a charter member of the FASB, has resigned from the Board effective June 30 of this year. His term runs until September 30, 1978.

Initial terms for the seven-member Board were staggered to ensure that no more than two members would complete their terms in a single year. Except for uncompleted terms, subsequent appointments and re-appointments are for five years. Members devote full time to the Standards Board and are fully compensated.

In a letter addressed jointly to FASB Chairman Marshall S. Armstrong and Ralph E. Kent, president of the Financial Accounting Foundation which is responsible for funding the FASB and appointing its members, Mr. Schuetze said, "My three years with the Board were more rewarding than I can describe. I deeply appreciate having been a charter member of the Board and having been associated with the trustees, the other members of the Board, and the staff to the Board for those three years."

Mr. Schuetze plans to rejoin the public accounting firm of Peat, Marwick, Mitchell & Co. as a partner. Messrs. Schuetze and Kirk, both 43, are the youngest members of the FASB.

FASB Chairman Marshall S. Armstrong expressed regret about Mr. Schuetze's resignation. "In his grasp of accounting theory and practice," Mr. Armstrong said, "and in his meticulous attention to the issues before us, Walter Schuetze has made a substantial contribution to the progress of the FASB." Mr. Armstrong also said he was gratified by Mr. Kirk's decision to continue on the Board.

At the time of his appointment to the FASB in 1973, Mr. Kirk was a partner in the public accounting firm of Price Waterhouse & Co. As a member of the Standards Board, he has served as co-chairman, with Mr. Schuetze, of the screening committee on emerging problems. Henceforth, Mr. Kirk will be the chairman of the screening committee.

Mr. Kent said the Board of Trustees of the Financial Accounting Foundation accepted Mr. Schuetze's resignation "with regret and deep appreciation for the skill and diligence with which he carried out his responsibilities as a member of the FASB." A committee of the Foundation trustees will begin work immediately, Mr. Kent said, on the process of evaluating potential replacements for Mr. Schuetze.

Financial Accounting Standards Board

HIGH RIDGE PARK. STAMFORD. CONNECTICUT 06905 | 203·329·8401

October 11, 1976

Mr. Victor O. Reinemer
Staff Director
Subcommittee on Reports, Accounting,
and Management
161 Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Reinemer:

As you requested, I am setting forth below the names, titles and affiliations of persons attending the meeting between the Financial Accounting Standards Board and representatives of the Business Roundtable in New York, September 28, 1976.

FASB Representatives

Marshall S. Armstrong	Chairman
Robert T. Sprouse	Vice Chairman
Oscar S. Gellein	Board Member
Donald J. Kirk	Board Member
Arthur L. Litke	Board Member
Robert E. Mays	Board Member

Roundtable Representatives

Charles L. Brown, Vice Chairman	-	American Telephone & Telegraph Co.
Frank T. Cary, Chairman	-	International Business Machines Corp.
E.M. deWindt, Chairman	-	Eaton Corporation
Reginald H. Jones, Chairman	-	General Electric Company
William F. Laporte, Chairman	-	American Home Products
Ralph Lazarus, Chairman	-	Federated Department Stores, Inc.
Thomas A. Murphy, Chairman	-	General Motors Corporation
Charles J. Pilliod, Jr., Chairman	-	The Goodyear Tire & Rubber Company
David Rockefeller, Chairman	-	Chase Manhattan Bank
Irving S. Shapiro, Chairman	-	E.I. du Pont de Nemours & Co., Inc.
J. Stanford Smith, Chairman	-	International Paper Company
George A. Stinson, Chairman	-	National Steel Corporation
Walter B. Wriston, Chairman	-	Citibank
G. Wallace Bates, President	-	The Business Roundtable

FASB

Purpose of the meeting was to have a wide-ranging discussion between the members of the Standards Board and a representative group of corporate chief executives concerning the FASB's mission, philosophy, and method of operation. In the normal course of its work the FASB is in frequent contact with the chief financial officers of many corporations. However, opportunities for members of the Board to exchange views with chief executive officers occur much less frequently. For many months the Board has perceived a need to broaden its understanding of how chief executives view the mission and accomplishments to date of the FASB.

The Business Roundtable became the vehicle for such a dialogue by virtue of the fact that two of its leading members, Thomas A. Murphy of General Motors and Reginald H. Jones of General Electric Company, have a keen interest in the FASB. Mr. Murphy was a trustee of the Financial Accounting Foundation for the first two years of its existence. Mr. Jones, a former accountant, was the principal speaker at the charter dinner for the FASB in March, 1973. There is no other significance in the fact that the meeting was held with members of the Business Roundtable rather than some other organization. Nor is there any significance in the fact that a member of the Business Roundtable acted as host. If it had been more convenient for Roundtable members to come to Stamford, they would have done so and the FASB would have been the host. However, for a group such as is listed above, New York is a more convenient location.

I trust this information is responsive to your request. If you require any additional information, please do not hesitate to call or write.

Sincerely,

Robert Van Riper

Robert Van Riper
Administrator
Public Information

RVR/c

TASK FORCES

STAFF STUDY--Private interests represented on FASB task forces

* Big eight firms   + Contributor to FASB   # Next Seven Firms

INTERIM FINANCIAL REPORTING

Morgan Stanley & Co.
+A. O. Smith Corp. (AY)
University of Chicago
+Pillsbury Company (TR)
+Caterpiller Tractor Co. (PW)
*Ernst & Ernst
*Peat, Marwick & Mitchell
*Touche Ross
+Clark Equipment Co. (PW)
+U. S. Industries, Inc. (EE)
Sterling Grace & Co.
*Arthur Andersen

INTEREST COSTS

+AMAX, Inc. (CL)
+TransAmerica Corp. (EE)
*Arthur Young
+Manufacturers Hanover Trust Co. (PMM)
*Touche Ross
+Sears Roebuck& Co. (TR)
+Citibank
+Public Service Electric & Gas (HS)
+NCR Corp. (PW)
+Household Finance Corp. (HS)
Irving Trust Company
+United States Steel Corp. (PW)
*Arthur Andersen
University of Texas
+Exxon Corp. (PW)
*Coopers Lybrand

FOREIGN CURRENCY TRANSLATION

*Peat Marwick & Mitchell
*Arthur Andersen
+Mobil Oil Corporation (AY)
+Morgan Guaranty Trust Co.
American Institute of CPAs
University of Washington
Clarkson, Gordon & Co.
New York University
Merrill Lynch, Pierce, Fenner & Smith
*Price Waterhouse
+Union Carbide Corporation (HC)
+Ford Motor Company (CL)
Hoover Institution on War, Revolution & Peace

TASK FORCES

STAFF STUDY--Private interests represented on FASB task forces--Continued

FUTURE LOSSES

+ITT Corp. (AA)
+Allstate Insurance Company
Commonwealth Edison Company (AA)
+Aetna Life & Casualty Co.
+Dow Chemical Co. (HS)
*Coopers Lybrand & Co.
Clarence Rainess & Co.
Columbia University
Blyth Eastman Dillon & Co. (HS)
Union Service Corporation (HS)
University of California
Fireman's Fund Insurance Company (PW)
*Arthur Young & Co.
#J. K. Lasser & Co.

CONCEPTUAL FRAMEWORK

Harvard University
*Arthur Andersen & Co.
*Coopers & Lybrand
Citicorp (PMM)
American Appraisal Associates, Inc. (AA)
+Exxon Corporation (PW)
*Ernst & Ernst
White, Weld & Co.
*Price Waterhouse & Co.
University at Texas at Austin

DEBTORS AND CREDITORS

*Haskins & Sells
National Association of Real Estate Investment Trusts
#S. D. Leisdorf & Co.
Builders Investment Group (SDL)
Merrill Lynch Pierce Fenner & Smith
+Connecticut General Life Insurance Co. (PW)
White & Case
+Manufacturers Hanover Trust (PMM)
Kuhn, Loeb & Co.
+United States Steel (PW)
First Chicago Corporation (AA)
Columbia University
*Peat, Marwick & Mitchell
Irving Trust Company
*Ernst & Ernst
Eastern Airlines (PW)

STAFF STUDY--Private interests represented on FASB task forces--Continued

EXTRACTIVE INDUSTRIES

+AMAX, Inc. (CL)
Smith, Barney & Co.
+Tesoro Petroleum Corporation (TR)
North Texas State University
+Standard Oil Company of Indiana (PW)
Donaldson, Lufkin & Jenrette
Forest Oil Corporation (PMM)
+Mobil Oil Corporation (AY)
*Price Waterhouse & Co.
DeGoyler & MacNaughton
*Coopers Lybrand
+Pennzoil Co. (AA)
*Arthur Anderson
First Manhattan Company (PMM)
*Touche Ross
*Arthur Young
+Continental Oil Company (AY)
+Citibank
Newmont Mining Corporation (AA)

LEASES

*Price Waterhouse
+J.C. Penney Co. (PMM)
Boston Company (CL)
University of Chicago
#Alexander Grant & Co.
Kidder Peabody & Co., Inc.
*Peat Marwick & Mitchell
+Morgan Guaranty Trust Co.
United States Leasing International (HS)
+American Electric Power Co. (HS)
*Arthur Andersen

SEGMENTS

#Hurdman & Cranstoun
+Peabody Galion Corp. (PMM)
New York University
*Arthur Young
+General Mills, Inc. (PMM)
+Honeywell, Inc. (HS)
+General Electric Co. (PMM)
+Eastman Kodak Company (PW)
Duff, Anderson & Clark
Federal Trade Commission
+Textron, Inc. (AY)
Northwestern University
*Touche Ross
+Eaton Corporation (EE)
Columbia Univeristy
+Standard Oil of Ohio (EE)

TASK FORCES

STAFF STUDY--Private interests represented on FASB task forces--Continued

EMPLOYEE BENEFIT PLANS

Towers, Perrin, Forster & Crosby, Inc.
U. S. Department of Labor
+Morgan Guaranty Trust Co.
Financial Analysts Federation
University of Pennsylvania
+Shell Oil Company (PW)
*Peat, Marwick & Mitchell
+Prudential Insurance Co. of America
Ernst & Ernst
UAW Social Security Department

COST OF PENSION PLANS

Towers, Perrin, Forster, & Crosby, Inc.
+General Electric Company (PMM)
+American Telephone & Telegraph Corp. (CL)
Motorola, Inc. (PMM)
*Arthur Young
+John Hancock Mutual Life Insurance Co. (EE)
*Price Waterhouse
Financial Analysts FEderation
+Harsco Corporation (CL)
*Touche Ross
+Shell Oil Company (PW)
*Peat Marwick & Mitchell
University of Pennsylvania

R & D AND SIMILAR COSTS

University of Illinois
+Lockheed Aircraft (AY)
Bache & Co. (AA)
Interstate Commerce Commission
*Chrysler Corporation (TR)
*Price Waterhouse
Ohio State University
*Arthur Andersen
+Caterpillar Tractor Company (PW)
First National Bank of Boston
First Manhattan Company (PMM)
+Robertshaw Controls Company (EE)
*Touche Ross
*Haskins Sells
A. M. Pullen Co.
Alza Corporation (AY)

STAFF STUDY--Private interests represented on FASB task forces--Continued

BUSINESS COMBINATIONS

+Standard Oil Company of Indiana (PW)
George S. Olive & Co.
Studebaker-Worthington, Inc. (AA)
*Ernst & Ernst
Times-Mirror Company (EE)
*Coopers Lybrand
*Touche Ross
University of North Carolina
Teledyne, Inc. (AA)
First Boston Corporation (HS)
Duff, Anderson & Clark
Booz, Allen Aquisition Services, Inc.

MATERIALITY

American Institute of CPAs
Stanford University
Massachusetts Financial Services, Inc.
Berkeley Bio-Engineering Co.
+St. Paul Companies (PMM)
+Manufacturers Hanover Trust Co. (PMM)
*Peat, Marwick & Mitchell
+Northwest Bancorporation (PMM)
Meaden & Moore
Indianapolis Newspapers, Inc.
Capital Research Company
* Haskins Sells
\+ Travelers Insurance Company (CL)
Gibson, Dunn & Crutcher
\+ Atlantic Richfield Co. (CL)

APPENDIX I
SECURITIES AND EXCHANGE COMMISSION

FEDERAL REGISTER, VOL. 41, NO. 152—THURSDAY, AUGUST 5, 1976

[Release Nos. 33–5729, 34–12662, 35–19629, IC–9369, AS–193, File No. S7–647]

ARTHUR ANDERSEN & CO.

Request for Partial Response and Solicitation of Comments on Certain Questions

On June 15, 1976, the public accounting firm of Arthur Anderson & Co. ("Andersen") filed a "petition" with the Commission requesting, essentially, that we consider whether to:

(1) revoke Instruction H(f) of Form 10–Q (17 CFR 249.308a) which requires that independent accountants express their judgment regarding the preferability of an accounting principle adopted when accounting principles are changed at the discretion of a registrant.

(2) Withdraw the statement of policy embodied in Accounting Series Release No. 150 (39 FR 1260) in which the Commission stated that it would consider accounting principles, standards and practices promulgated by the Financial Accounting Standards Board (FASB) as contrary to such FASB promulgations as having no such support.[1]

(3) define the current meaning of the term "substantial authoritative support."

Preferability

Instruction H(f) to Form 10–Q was adopted by the Commission in Accounting Series Release No. 177 on September 10, 1975 (40 FR 55837). It was originally proposed for comment in essentially the same form on December 19, 1974[2] and comments were received on it and carefully considered by the Commission. In addition, the issues regarding this instruction were presented at public hearings held in 1975 on the Commission's interim reporting proposals.

Subsequent to adoption of Instruction H(f), the Auditing Standards Executive Committee of the AICPA (AudSEC) requested that the Commission reconsider the instruction and, in response, the Commission held a public meeting with the Committee on April 23, 1976 at which the issues were discussed and at which time several submissions were received. On April 30, 1976, the Commission advised AudSEC that, after further consideration, it saw no reason to change its conclusion.

The substantive issues involving Instruction H(f) therefore have been thoroughly aired and the reasons for the Commission's conclusions have been fully set forth. In the absence of any showing by Andersen that it has presented any new substantive reasons for reconsideration of our action, the Commission has no basis before it warranting further reconsideration of the matter.

Establishment of accounting principles

The second and third actions requested by Andersen raise fundamental issues of importance upon which the Commission has concluded it wishes to have the benefit of public comment before determining what action, if any, it may be appropriate to take. In addition, the Commission expects to hold a public meeting on the issues with invited representatives of persons with significant interests in financial reporting.

A cornerstone of the disclosure process envisioned by the securities laws is the financial information included in audited financial statements. Since 1933, when Congress determined to rely on independent accountants to provide assurance of reliability in financial statements, the Commission has relied upon the judgments of the accounting profession both in individual factual circumstances and in the establishment of principles of general acceptance. In 1938, the Commission stated its administrative policy with respect to financial statements in Accounting Series Release No. 4 (11 FR 10913):

"In cases where financial statements filed with this Commission pursuant to its rules and regulations under the Securities Act of 1933 or the Securities Exchange Act of 1934 are prepared in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be presumed to be misleading or inaccurate despite disclosures contained in

[1] The Commission noted in this connection that Rule 203 of the Rules of Conduct of the Code of Ethics of the American Institute of Certified Public Accountants provides that it is necessary to depart from accounting principles promulgated by the body designated by the Council of the AICPA if, due to unusual circumstances, failure to do so would result in misleading financial statements and that, in such a case, the use of other principles may be accepted or required by the Commission.

[2] Release Nos. 33–5549, 34–11142, 35–18718 (40 FR 1079).

the certificate of the accountant or in footnotes to the statements provided the matters involved are material. In cases where there is a difference of opinion between the Commission and the registrant as to the proper principles of accounting to be followed, disclosure will be accepted in lieu of correction of the financial statements themselves only if the points involved are such that there is substantial authoritative support for the practices followed by the registrant and the position of the Commission has not previously been expressed in rules, regulations or other official releases of the Commission, including the published opinions of its Chief Accountant."

In 1973, various private sector groups concerned with financial reporting established the Financial Accounting Standards Board and this body was designated by the accounting profession as the entity having the responsibility for considering and promulgating accounting standards and interpretations. Following this action, the Commission issued a Statement of Policy (ASR 150) reflecting its recognition of the FASB's role in the setting of accounting principles, standards and practices. ASR 150 reflected an explicit statement of the Commission's administrative practice in carrying out its responsibilities under the securities laws. Historically, the Commission has accepted as having substantial authoritative support those practices which have been identified by the accounting profession as standards to be followed by members of the profession. With the creation of the FASB, the Commission believed that it should publicly indicate that it viewed the standards, practices and interpretations issued by the FASB as constituting those practices having substantial authoritative support.

Andersen requests that the Commission withdraw these policies which have governed the manner by which it has determined whether financial statements meet the requirements of the Securities Acts. Before responding to Andersen's request, the Commission hereby solicits public comment on the following basic issues raised:

1. Should the Commission continue its policy of recognizing the pronouncements of the Financial Accounting Standards Board as providing a frame of reference for publicly held companies to satisfy their statutory disclosure obligations?

2. Should the Commission further define the phrase "substantial authoritative support"?

3. Should the Commission further define the phrase "accounting principles and practices" used in Rule 2–02(c) of Regulation S–X (17 CFR 210.2–02(c))?

Comments in triplicate should be addressed to the Secretary, Securities and Exchange Commission, Washington, D.C. 20549 and should be referenced to File S7–647. Comments should be received by September 15, 1976. All comments will be available for public inspection.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

JULY 27, 1976.

[FR Doc.76–22737 Filed 8–4–76;8:45 am]

SEC Rule 210.2-01 re Qualifications of Accountants

Qualifications and Reports of Accountants

Source: §§ 210.2-01 to 210.2-05 appear at 37 F.R. 14594, July 21, 1972, unless otherwise noted.

§ 210.2-01 Qualifications of accountants.

(a) The Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of the place of his residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

(b) The Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent. For example, an accountant will be considered not independent with respect to any person or any of its parents, its subsidiaries, or other affiliates (1) in which, during the period of his professional engagement to examine the financial statements being reported on or at the date of his report, he or his firm or a member thereof had, or was committed to acquire, any direct financial interest or any material indirect financial interest; (2) with which, during the period of his professional engagement to examine the financial statements being reported on, at the date of his report or during the period covered by the financial statements, he or his firm or a member thereof was connected as a promoter, underwriter, voting trustee, director, officer, or employee, except that a firm will not be deemed not independent in regard to a particular person if a former officer or employee of such person is employed by the firm and such individual has completely dissociated himself from the person and its affiliates and does not participate in auditing financial statements of the person or its affiliates covering any period of his employment by the person. For the purposes of this § 210.2-01 the term "member" means all partners in the firm and all professional employees participating in the audit or located in an office of the firm participating in a significant portion of the audit.

(c) In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission.

RELEASE NO. 4

April 25, 1938

Administrative policy on financial statements.

The Securities and Exchange Commission today issued the following statement of its administrative policy with respect to financial statements:

"In cases where financial statements filed with this Commission pursuant to its rules and regulations under the Securities Act of 1933 or the Securities Exchange Act of 1934 are prepared in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be presumed to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material. In cases where there is a difference of opinion between the Commission and the registrant as to the proper principles of accounting to be followed, disclosure will be accepted in lieu of correction of the financial statements themselves only if the points involved are such that there is substantial authoritative support for the practices followed by the registrant and the position of the Commission has not previously been expressed in rules, regulations, or other official releases of the Commission, including the published opinions of its chief accountant."

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

ACCOUNTING SERIES
Rel. No. 150/December 20, 1973

STATEMENT OF POLICY ON THE ESTABLISHMENT AND IMPROVEMENT OF ACCOUNTING PRINCIPLES AND STANDARDS

Various Acts of Congress administered by the Securities and Exchange Commission clearly state the authority of the Commission to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements to be filed under the Acts and the responsibility to assure that investors are furnished with information necessary for informed investment decisions. In meeting this statutory responsibility effectively, in recognition of the expertise, energy and resources of the accounting profession, and without abdicating its responsibilities, the Commission has historically looked to the standard-setting bodies designated by the profession to provide leadership in establishing and improving accounting principles. The determinations by these bodies have been regarded by the Commission, with minor exceptions, as being responsive to the needs of investors.

The body presently designated by the Council of the American Institute of Certified Public Accountants (AICPA) to establish accounting principles is the Financial Accounting Standards Board (FASB). This designation by the AICPA followed the issuance of a report in March 1972 recommending the formation of the FASB, after a study of the matter by a broadly based study group. The recommendations contained in that report were widely endorsed by industry, financial analysts, accounting educators, and practicing accountants. The Commission endorsed the establishment of the FASB in the belief that the Board would provide an institutional framework which will permit prompt and responsible actions flowing from research and consideration of varying viewpoints. The collective experience and expertise of the members of the FASB and the individuals and professional organizations supporting it are substantial. Equally important, the commitment of resources to the FASB is impressive evidence of the willingness and intention of the private sector to support the FASB in accomplishing its task. In view of these considerations, the Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB with the expectation that the body's conclusions will promote the interests of investors.

In Accounting Series Release No. 4 (1938) the Commission stated its policy that financial statements prepared in accordance with accounting practices for which there was no substantial authoritative support were presumed to be misleading and that footnote or other disclosure would not avoid this presumption. It also stated that, where there was a difference of opinion between the Commission and a registrant as to the proper accounting to be followed in a particular case, disclosure would be accepted in lieu of

correction of the financial statements themselves only if substantial authoritative support existed for the accounting practices followed by the registrant and the position of the Commission had not been expressed in rules, regulations or other official releases. For purposes of this policy, principles, standards and practices promulgated by the FASB in its Statements and Interpretations 1/ will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered 2/ to have no such support.

In the exercise of its statutory authority with respect to the form and content of filings under the Acts, the Commission has the responsibility to assure that investors are provided with adequate information. A significant portion of the necessary information is provided by a set of basic financial statements (including the notes thereto) which conform to generally accepted accounting principles. Information in addition to that included in financial statements conforming to generally accepted accounting principles is also necessary. Such additional disclosures are required to be made in various fashions, such as in financial statements and schedules reported on by independent public accountants or as textual statements required by items in the applicable forms and reports filed with the Commission. The Commission will continue to identify areas where investor information needs exist and will determine the appropriate methods of disclosure to meet these needs.

It must be recognized that in its administration of the Federal Securities Acts and in its review of filings under such Acts, the Commission staff will continue as it has in the past to take such action on a day-to-day basis as may be appropriate to resolve specific problems of accounting and reporting under the particular factual circumstances involved in filings and reports of individual registrants.

The Commission believes that the foregoing statement of policy provides a sound basis for the Commission and the FASB to make significant contributions to meeting the needs of the registrants and investors.

By the Commission.

George A. Fitzsimmons
Secretary

1/ Accounting Research Bulletins of the Committee on Accounting Procedure of the American Institute of Certified Public Accountants and effective opinions of the Accounting Principles Board of the Institute should be considered as continuing in force with the same degree of authority except to the extent altered, amended, supplemented, revoked or superseded by one or more Statements of Financial Accounting Standards issued by the FASB.

2/ It should be noted that Rule 203 of the Rules of Conduct of the Code of Ethics of the AICPA provides that it is necessary to depart from accounting principles promulgated by the body designated by the Council of the AICPA if, due to unusual circumstances, failure to do so would result in misleading financial statements. In such a case, the use of other principles may be accepted or required by the Commission.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

OFFICE OF THE CHAIRMAN

August 22, 1975

Honorable Frank G. Zarb
Administrator
Federal Energy Administration
Washington, D. C. 20461

Dear Frank:

In response to your letter of August 7, 1975, I enclose a statement of our views on the amendment to Title VIII of H. R. 7014 which Congressman Moss proposed.

We have not taken a position on the sections of the amendment which would authorize the Comptroller General to audit "energy information," but we do oppose those sections which would authorize him to audit the financial statements of certain companies filing with the Commission. Such financial statements are now audited by independent public accountants as prescribed in the Securities Act of 1933 and our rules. We see audits of financial statements by the Comptroller General as constituting needless and costly duplication of effort. We are also concerned about the change in public-private relationships caused by interjecting the government into the audit process of our registrants.

While we have no objection to audits of energy information by the Comptroller General, we believe it might be more cost effective to ask that energy information be attested to by independent public accountants and that the Comptroller General only be given oversight and investigatory responsibilities in this connection. This would certainly be far more economical for the government since the cost of independent attestation of energy information would be borne by the oil industry.

We also oppose certain sections of the amendment which would require the Securities and Exchange Commission by rule to prescribe accounting practices for the petroleum industry.

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We are continuing discussions on these matters with staff members of Congressman Moss and will advise you of developments as they occur.

If we can be of any further assistance in this matter, please let us know. Specific questions can be addressed to me or to Sandy Burton, the Commission's Chief Accountant (755-1180).

Sincerely,

Ray Garrett, Jr.
Chairman

Enclosure

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE COMMISSIONER

CHAIRMAN'S ...
HAND DELIVERED

OCT 3 1975

Honorable Clarence J. Brown
House of Representatives
Washington, D. C. 20515

Dear Mr. Brown:

This is in response to your letter of September 26, 1975 in which you asked for the Commission's views on Title IX of H. R. 7014 as passed by the House.

We believe that certain provisions of this title would be seriously detrimental to the Commission's objectives and policies as they are currently exercised under Congressional mandate and, accordingly, we cannot support its inclusion in its current form in the energy legislation now being considered by the House and Senate conferees.

We are most concerned with the provisions of Sec. 803 which would require the Securities and Exchange Commission to prescribe accounting practices by rule for petroleum companies within 21 months. This would directly involve the Commission in setting accounting standards and would undermine a long standing and successful policy of relying upon the private sector to develop such standards under our oversight. It would also require the Commission to develop standards covering a highly complex area in an unreasonably short period of time to permit the thought, study and consultation necessary to develop sound standards.

The Commission has worked closely with the accounting profession and the business and academic communities to develop an accounting standard-setting apparatus. Two years ago the Financial Accounting Standards Board (FASB) was created to improve the then existing apparatus. We believe that the FASB is working effectively in the interests of investors and other users of financial statements, and we cooperate closely with the Board. Its procedures provide for consultation, public exposure of the issues prior to taking a position and public exposure of a draft standard prior to adoption. The General Accounting Office is represented on the Board's Advisory Council and the former chief accountant of the Federal Power Commission is a member of the Board.

We believe strongly that the current standard-setting apparatus is a good one and should not be upset. Because the FASB is a recently created organization, care must be taken that its credibility is not eroded. We believe that a statutorily required governmental rulemaking procedure at this time to establish accounting standards by rule would seriously impair the effectiveness of the Board.

The Commission is confident that adequate accounting standards can be achieved by the FASB in the oil and gas area within three years with the cooperation of the Commission and under its broad oversight, consistent with its policy of supporting the FASB articulated in the Commission's Accounting Series Release No. 150.

We are also concerned about Sec. 801 of Title IX which extends the auditing responsibility of the Comptroller General to include "oversight audits" and "verification audits" of the financial statements of such companies filed with the Securities and Exchange Commission pursuant to the securities acts. Congress by statute assigned audit responsibility to independent accountants in the Securities Act of 1933 and specifically gave the Commission authority to require independent audits by rule under the Securities Exchange Act of 1934, which the Commission has done. We believe that Title IX effects a highly significant change in this public-private sector relationship by interjecting the government into the auditing process for private companies registered with the Commission. We find it highly undesirable to jeopardize the relationship since it has existed for over forty years and has operated with a very high level of success.

We are also concerned by the implications which may be drawn from the approach adopted in the amendment concerning the reliability and adequacy of the audit process in general. The Commission believes that audits by independent accountants have provided satisfactory assurance of the reliability of financial statements filed with the Commission. In addition, the Commission has broad investigative powers which permit it to investigate financial statements and audits which appear to be inadequate and to sanction registrants and auditors who file or attest to such statements. Enforcement actions have been brought in many cases, and auditors have been named as defendants in several of these. We believe that our regulatory and enforcement activities, together with the good faith efforts of registrants and

professionals, have resulted in generally high quality financial statements being available to the public. We question the need for the involvement of another government agency in this process.

We have no objection to the sections of Title IX which give the Comptroller General the authority to examine, to the extent he determines necessary, the books and records of companies required to submit energy information to agencies of the Federal Government for the purpose of assessing the accuracy, reliability and adequacy of that energy information.

We would of course be pleased to discuss our views with you in greater depth should you wish us to do so.

Sincerely,

Philip A. Loomis, Jr.
Senior Commissioner

ABRAHAM RIBICOFF, CONN., CHAIRMAN
JOHN L. MC CLELLAN, ARK. CHARLES H. PERCY, ILL.
HENRY M. JACKSON, WASH. JACOB K. JAVITS, N.Y.
EDMUND S. MUSKIE, MAINE WILLIAM V. ROTH, JR., DEL.
LEE METCALF, MONT. BILL BROCK, TENN.
JAMES B. ALLEN, ALA. LOWELL P. WEICKER, JR., CONN.
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JOHN GLENN, OHIO

RICHARD A. WEGMAN
CHIEF COUNSEL AND STAFF DIRECTOR

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VIC REINEMER, STAFF DIRECTOR
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161 RUSSELL BUILDING
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United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

29 January 1976

Mr. George A. Fitzsimmons
Secretary
Securities & Exchange Commission
Washington, D.C. 20549

Re: Replacement Cost Data
(File No. S7-579)

Dear Mr. Fitzsimmons:

I strongly oppose this proposed rule to have companies include the estimated effects of inflation on operations in their financial reports.

Adoption of this proposal would result in burdensome reporting for companies, while simultaneously misleading and confusing investors, Congress, and the public.

Significantly, the Securities and Exchange Commission is only proposing to require "inflation adjustments" for productive assets, depreciation charges, cost of sales, and inventory values. Replacement costs associated with these items tend to give the illusion that inflation only affects the expenses of businesses, and that the effects of inflation on operations is always detrimental. The SEC is not also proposing that companies disclose to investors and the public the beneficial effects of inflation on the dollars they must pay to others. The world of fantasy should not be entered selectively.

The inflation adjustments proposed by the SEC represent an unprecedented departure from accounting systems based on

actual, realized costs. There is already sufficient uncertainty and disagreement among accountants regarding the treatment of various accomplished transactions in financial reports. Speculative inflation adjustments will further detract from public confidence in the certainty of financial statements.

This proposed rule is objectionable for several reasons:

1) It assumes that covered items will be replaced. Of course, many assets are never replaced, and some are functionally replaced by different assets or external contracting. The public is thus misled into believing that reporting companies might face substantial financing which will never occur.

2) The proposal does not specify what method should be used in estimating replacement costs, but rather encourages respondents to "experiment" with various methods. The result will be a vast array of inspired and imaginative estimates, each one designed to project management views. Few of the replacement cost estimates will be comparable, so the existing problem of incomparability among financial reports will be further exacerbated. Determination of valid reporting methods should precede the adoption of reporting regulations.

3) While the proposed rule recognizes the difference between reproduction cost and replacement cost, it does not recognize other methods of valuation such as the discounted present value of a going business or stock market valuation. Respondent companies are more than mere collections of assets.

Valuation is a complex legal and economic process even when experts are used to actually examine and appraise assets. Estimation of current values is speculative because there is rarely a completed transaction on which to base reliable value estimates for unmarketed assets. The one area where replacement valuation has received wide application with professional expertise over many years is the valuation of utility assets for setting rates. The result has been uncertain and self-serving value estimates which induced almost every regulatory commission in the Nation to abandon replacement valuation in favor of original costs.

The valuation methods suggested in the proposed rule are purely arbitrary and bear no relation at all to the effects of inflation on individual assets or business operations. The SEC requests respondents to experiment in finding an easily applied measure of inflation, yet broader inflation measurements will yield increasingly speculative replacement values. I cannot see how broad inflation adjustments to selected items in SEC reports will be meaningful to the public when extensive replacement valuations by experts have been rejected by regulatory commissions as being too speculative.

4) Adjusting all financial items for inflation yields purchasing gains as well as losses. Net debtors repay lenders with dollars of decreased value--a gain for them which must be realized in income. (A fine article on this subject and business opposition to inflation accounting appeared in the 12 November, 1975 issue of the Wall Street Journal on page 42.)

The Financial Accounting Standards Board has proposed complete inflation adjustments. I believe that would involve even more speculation, but at least the FASB has recognized that there are both gains and losses from inflation.

5) Of particular note is the Commission's justification for proposing inflation adjustments. Tax policy is mentioned as one reason:

> "In addition, the Commission has noted the development of proposals to permit business entities to calculate depreciation for tax purposes on the basis of current replacement cost. Such an approach would reflect in the calculation of taxable income the current value of capital consumed. The development of regular replacement cost data on a systematic basis for reporting to investors will enable the makers of tax policy to determine explicitly the effect of present taxes on economic capital and to estimate the impact of alternatives. It would also assist corporations in creating a data base which may ultimately be used for tax reporting purposes."

Using current accounting procedures, businesses have been quite resourceful in persuading Congress to bestow substantial tax benefits. I do not believe the SEC needs to embark on speculative and burdensome reporting regulations to encourage and facilitate the lobbying efforts of business interests.

The SEC could better spend its time and resources in developing accounting standards which will correct the financial misrepresentation and cover-ups of illegal activities found in several recent examples. Excessive flexibility and laxity in accounting standards have caused substantial public doubt over the certainty and reliability of financial statements.

This subcommittee has worked closely with the SEC to achieve accurate reporting of corporate ownership and control. Concern has been expressed by SEC staff over the "burden" of reporting this important factual information. Now the SEC is proposing that speculative estimates of dubious valuations be reported using whatever method or guess that seems expedient. This is the type of Federal reporting which is truly burdensome.

I am amazed that the SEC is proposing to burden respondents with speculative inflation adjustments, especially when there remain substantial deficiencies and gaps in the reporting of necessary factual data. This rule-making should be terminated immediately.

Very truly yours,

Lee Metcalf

(From the Wall Street Journal, Feb. 11, 1976)

SEC Drops Proposal On Auditing Guides For Quarterly Data

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—The Securities and Exchange Commission withdrew proposed auditing standards for quarterly results, saying the accounting profession has come up with satisfactory procedures of its own.

The SEC's proposal, published last Sept. 10, had been designed to clarify auditors' responsibilities under new SEC regulations that require publicly held corporations to report to the SEC considerably more quarterly financial data than in the past. Under the new rules, larger and more actively traded companies must include quarterly information in reports.

Although the footnote is to be labeled "unaudited," it must appear in the audited portion of the annual financial statements, and the SEC acknowledged in September that "independent accountants will be associated with such a note when they report on (annual) financial statements."

Therefore, the SEC had proposed accounting rule changes that would have required close analysis by auditors of a client company's accounting controls and financial data. The proposals also called for auditors to question company officials about important new or unusual events during a quarter.

Yesterday, the SEC said that the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants had continued to study auditor involvement in the interim reporting process and had issued a statement in December. The commission found that the "standards and procedures set forth in that statement appropriately define the role of the auditor in the interim reporting process." Therefore, the SEC decided to rely on the professional group's standards rather than issuing its own.

(From CPA Letter, May 24, 1976)

SEC Appoints Replacement Cost Advisory Committee

As stated in Accounting Series Release No. 190, the Securities and Exchange Commission has appointed an advisory committee on replacement cost implementation. Its purpose is to advise the chief accountant on implementation questions and the chief accountant is seeking such questions as they arise. Following meetings of the committee, the first of which was held on May 18, a staff accounting bulletin will be issued by the chief accountant containing his recommended solutions.

The following practicing CPAs are among the 29-member group: Robert W. Berliner, Arthur Young & Company; Howard A. Groveman, Alexander Grant & Co., Kenneth P. Johnson, Coopers & Lybrand; William G. Joyner, Price Waterhouse & Co.; Donald P. Kern, Peat, Marwick, Mitchell & Co.; Albert A. Koch, Ernst & Ernst; W. Thomas Porter, Touche Ross & Co.; Kenneth W. Stringer, Haskins & Sells; Arthur R. Wyatt, Arthur Andersen & Co.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHIEF ACCOUNTANT

January 28, 1976

Mr. John B. Chesson, Counsel
Subcommittee on Reports,
Accounting & Management
United States Senate
161 RSOB
Washington, D.C. 20510

Dear Jack:

In accordance with our discussion at the conference on January 19, I have enclosed a set of the Accounting Series Releases issued to this date. In the compilation of the first 112 releases the texts of some of them have been omitted because the material or information originally contained in them has no current value. We also have a set of basic accounting rules entitled Regulation S-X which together with the ASR's govern the form and content of financial statements filed with the Commission. This regulation is contained in the Code of Federal Regulations as Part 210 of Title 17, Chapter II. The three Staff Accounting Bulletins enclosed comprise a new series of releases announced in November 1975 in ASR No. 180 to disseminate information to the public regarding interpretations and practices followed by the staff in administering the disclosure requirements of the securities laws.

The series of accounting releases was started in 1937 as a program, as stated in ASR No. 1, for the publication from time to time of opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions. Many of the current releases contain such opinions or other informational, interpretive or exhortative statements of the Commission on accounting and auditing matters; many others are the vehicles for the adoption of amendments to the rules in Regulation S-X or to the requirements for financial statements in the various filing forms; and some contain decisions in disciplinary proceedings under Rule 2(e) of the Commission's Rules of Practice concerning accountants appearing before it.

For your convenience in perusing the releases I have listed below some of the more significant recent releases in the three categories.

I. Opinions and statements of the Commission.

ASR No. 123 - Standing Audit Committees of Outside Directors.

ASR No. 126 - Independence of Accountants--Guidelines and Examples of Situations Involving the Independence of Accountants.

ASR No. 142 - Reporting Cash Flow and Other Related Data.

ASR No. 150 - Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards.

ASR No. 151 - Disclosure of Inventory Profits Reflected in Income in Periods of Rising Prices.

ASR No. 163 - Capitalization of Interest by Companies Other Than Public Utilities. (Regulation S-X is also amended.)

ASR No. 166 - Disclosure of Unusual Risks and Uncertainties in Financial Reporting.

ASR No. 180 - Notice of the Institution of a Series of Staff Accounting Bulletins.

ASR No. 188 - Interpretive Statement by the Commission on Disclosure by Registrants of Holding of Securities of New York City and Accounting for Securities Subject to Exchange Offer and Moratorium.

II. Amendments to Regulation S-X and filing forms.

ASR No. 138 - Notice of Adoption of Amendments to Forms 8-K, 10-K, 12-k, S-1, S-7, S-8, S-9, S-11, 10 and 12 Requiring Increased Disclosure of Unusual Charges and Credits to Income.

ASR No. 147 - Notice of Adoption of Amendments to Regulation S-X Requiring Improved Disclosure of Leases.

ASR No. 148 - Notice of Adoption of Amendments to Regulation S-X and Related Interpretations

and Guidelines Regarding Disclosure of Compensating Balances and Short-Term Borrowing Arrangements.

ASR No. 149 - Notice of Adoption of Amendment to Regulation S-X to Provide for Improved Disclosure of Income Tax Expense.

ASR No. 159 - Notice of Adoption of Amendments to Guide 22 of the Guide for Preparation and Filing of Registration Statements Under the Securities Act of 1933 and Adoption of Guide 1 of the Guides for Preparation and Filing of Reports and Registration Statements under the Securities Exchange Act of 1934 (Textual Analysis of Summary of Earnings or Operations).

ASR No. 165 - Notice of Amendments to Require Increased Disclosure of Relationships Between Registrants and Independent Public Accountants.

ASR No. 177 - Notice of Adoption of Amendments to Form 10-Q and Regulation S-X Regarding Interim Financial Reporting.

III. Decisions in Rule 2(e) proceedings.

ASR No. 144 - Order Instituting Proceedings and Imposing Remedial Sanctions--In the Matter of Laventhol, Kreskstein Horwath & Howath.

ASR No. 153 - Findings, Opinion and Order Accepting Waiver and Consent and Imposing Remedial Sanctions--In the Matter of Touche Ross & Co.

ASR No. 157 - Findings and Opinion Accepting Waiver Consent and Imposing Remedial Sanctions--In the Matter of Arthur Andersen & Co.

ASR No. 173 - Opinion and Order in a Proceeding Pursuant to Rule 2(e) of the Commission's Rules of Practice--In the Matter of Peat, Marwick, Mitchell & Co.

ASR No. 174 - Opinion and Order Instituting Proceedings and Imposing Remedial Sanctions--In the Matter of Harris, Kerr, Forster & Company.

If you wish further information regarding our accounting releases, rules and regulations, please let me know.

I believe your attention should also be called Manuel Cohen's Commission on Auditor Responsibilities which is currently studying a number of the issues which we discussed at lunch. I enclose a copy of a preliminary statement by that Commission. I think you would find a meeting with Mr. Cohen productive.

Finally, I enclose a book which was issued at a conference chaired by Manuel Cohen and myself which has some material that may be of interest in your inquiry. A similar program for 1976 will be held in New York this April which might be worth attending. I would be happy to arrange for your attendance without any fee if you would like to do so.

Sincerely,

Sandy Burton

John C. Burton
Chief Accountant

Enclosures

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United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

1 March 1976

The Honorable Roderick Hills
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Hills:

This subcommittee is reviewing the accounting responsibilities of certain Federal agencies. We are especially interested in the setting of accounting rules, principles, or standards which must be followed by businesses or accounting firms as a result of determinations made by Federal agencies.

Please furnish us with a concise description and summary of your agency's accounting responsibilities and the legal authority from which the accounting responsibilities are derived. A brief description of your agency's authority to compel compliance, punish non-compliance, and gain access to accounting-related records, procedures, or other necessary information should also be included.

Questions, if any, regarding this request should be directed to subcommittee counsel, Jack Chesson, at 224-1474.

Very truly yours,

Original signed by

Lee Metcalf

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

APR 30 1976

The Honorable Lee Metcalf
Subcommittee on Reports, Accounting,
and Management of the Committee on
Government Operations
United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

This is in response to your letter of March 1, 1976, concerning a review of the accounting responsibilities of certain federal agencies which the Subcommittee on Reports, Accounting and Management is presently conducting. You have asked that the Commission furnish the Subcommittee with a concise summary of its authority and responsibility concerning the setting of accounting principles, and with a brief description of the Commission's authority to compel compliance with such principles.

1. Authority and Responsibility for Setting Accounting Rules, Principles or Standards

a. Authority over securities issuers

The Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, and the Investment Company Act of 1940 each require various classes of securities issuers to register with the Commission, and, incident to such registration, to furnish financial information. 1/ Each of these four acts authorizes the Commission to prescribe the particular financial statements which registrants must file, the form and content of such statements, and the accounting standards and procedures to be followed in their preparation. 2/ Section 13(b) of the Securities Exchange Act of 1934 is typical of the Commission's authority in this regard, and is the section with perhaps the widest applicability. 3/ Section 13(b) provides, in pertinent part:

"The Commission may prescribe, in regard to reports made pursuant to this title, the form or forms in which the required information shall be set forth, the items or details to be shown in the balance sheet and the earnings statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the prepartion, where the Commission deems it necessary or desirable, of separate and/or consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer; . . . ." 4/

In considering the impact and operation of the Commission's accounting rules, it should also be noted that the Securities Act requires that the financial statements filed with the Commission by registrants under the Act "shall be certified by independent public or certified accountants." 5/ Similarly, the Securities Exchange Act, the Public Utility Holding Company Act, and the Investment Company Act provide that the Commission may require that the financial statements of registrants filed under each Act be certified by independent accountants, and the Commission has promulgated such rules under each Act. 6/

In addition to its specific statutory authority to prescribe the form and content of financial statements, the Commission also has general rulemaking authority under each of the four Acts mentioned above, including the authority "to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions" of the various Acts, and authority to define accounting, technical, trade and other terms used in the Acts. 7/

b. Authority over securities industry

The preceding discussion of the Commission's authority is directed primarily to its power to prescribe the form and content of the financial statements of securities issuers. It should also be noted that the Commission has broad authority over the accounting practices of certain persons engaged in the securities business, regardless of whether such persons have themselves issued securities. Section 17 of the Securities Exchange Act, 15 U.S.C. 78q,

for example, requires national securities exchanges, exchange members, broker-dealers, securities associations, municipal securities dealers, securities information processors, transfer agents, clearing agencies, and the Municipal Securities Rulemaking Board to make and keep such records and reports as the Commission may require. Section 17(e) requires every registered broker or dealer to file annually with the Commission a balance sheet and an income statement certified by an independent public accountant. 8/ The Commission is also authorized to require such other financial information concerning brokers or dealers as it deems appropriate.

Similarly, the Investment Advisers Act, 15 U.S.C. 80b-1 et seq., requires the registration of persons engaged in the business of advising others concerning securities transactions. See 15 U.S.C. 80b-2(a)(11), 80b-2. Every investment adviser is required, under Section 204 of the Act, 15 U.S.C. 80b-4, to maintain such "accounts" and make such "reports" as the Commission may, by rule, require.

c. Exercise of Commission authority

Under the statutory authority described above, 9/ the Commission has prescribed, in the various registration and periodic reporting forms used by those registered with it, the financial statements to be furnished. In addition, it has adopted a set of basic financial statement presentation rules entitled Regulation S-X, which generally govern the form and content of financial statements and related footnote and schedule disclosures. 10/ Further, the Commission has published a series of accounting releases starting in 1937 for the purpose of contributing to the development of uniform standards and practices in relation to major accounting questions. These releases deal primarily with disclosure matters but, when necessary, also have dealt with accounting principles or standards.

The federal securities laws and the Commission's rules, however, are consistent with the view that primary responsibility should rest with the accounting profession itself to audit registrants' financial statements in accordance with the standards of the profession and to report on whether the financial statements are presented in conformity with generally accepted accounting principles established by the profession. Accordingly, the Commission has refrained as much as possible from rulemaking with respect to accounting principles, standards, and procedures and has instead followed

a policy of encouraging and cooperating with the standard-setting bodies of the profession in the development of sound accounting standards and procedures. The Commission's first Chief Accountant initially stated this policy at the annual meeting of the American Institute of Accountants (now the American Institute of Certified Public Accountants) in 1937:

> "As a matter of fact, I think I have emphasized at numerous times that the policy of the Securities Exchange Commission was to encourage the accountants to develop uniformity of procedure themselves, in which ease we would follow. We expected to be able to follow the better thought in the profession and only as a last resort would the Commission feel the necessity to step in.
>
> The expressions of opinion that have come from my office have been expressions of opinion as to what we considered to be the most generally accepted accounting practice among the better accountants in the country and not a promulgation of any new ideas or anything that had not been followed by accountants rather generally.
>
> If the time comes when the Commission is convinced that a procedure which is not generally accepted in the profession is a procedure that should nevertheless be followed, the matter will be handled not through the release of an opinion by the Chief Accountant, but through a rule or regulation of the Commission requiring that such procedure be followed." 11/

The accounting standards or principles of the accounting profession, which are known as generally accepted accounting principles, have been promulgated by committees or boards appointed or sponsored by the American Institute of Certified Public Accountants. A Committee on Accounting Procedure, comprised of prominent members of the Institute serving on a voluntary part-time basis, initially began in 1938 a program of research and the publication of opinions entitled "Accounting Research Bulletins." This committee issued 51 Bulletins through August 1959 when it was replaced by the Accounting Principles Board, also comprised of prominent members serving on a voluntary part-time basis, which was empowered to

conduct more extensive research and to issue guiding principles more expeditiously. Thirty-one opinions of the Accounting Principles Board were issued through June 1973 when the Board was replaced by the Financial Accounting Standards Board (FASB).

The FASB was created based on the recommendations of a study group established by the AICPA and chaired by former SEC Commissioner Francis M. Wheat. That group, after public hearings and considerable research, concluded that accounting principles could best be set by a full-time body in the private sector. A financial accounting foundation, sponsored by the AICPA, the Financial Executives Institute, the Financial Analysts Federation, The National Association of Accountants, the American Accounting Association and the Securities Industry Association, and comprised of representatives of leading professional organizations, appoints the members of the Board. In addition, this foundation appoints an advisory council (the members of which serve on a voluntary basis) and also provides the funding for the FASB. The FASB had issued 12 Statements of Financial Accounting Standards as of March 31, 1976.

The Commission, through its Chief Accountant, has maintained oversight of the Financial Accounting Standards Board and its predecessor standard-setting bodies, with respect to the relationship between the work of these bodies and the Commission's responsibility to insure appropriate disclosure in financial statements filed pursuant to the federal securities laws. This is accomplished by consultations and close liaison with the Board on its ongoing projects and its deliberations on new projects. The Commission has noted with favor that the administrative procedures adopted by the Board with respect to study and research, public hearings, and solicitation of comments on proposals in the process of development and issuance of accounting standards are similar to the procedures followed by the Commission in rulemaking.

2. Methods of Compelling Compliance

Finanical data in registration statements and periodic reports filed with the Commission under the various Acts generally are reviewed by the appropriate operating divisions of the Commission. This review is to determine whether, among other things, the financial data conform to the requirements for the form and content of financial statements, whether such data are presented in conformity

with generally accepted accounting principles, and whether the financial statements are audited by independent accountants. When questions arise in the normal review process regarding any deficiencies, whether related to accounting treatment or otherwise, in a Securities Act registration statement, the Commission may refuse to accelerate the effective data of the statement. 12/ This has the effect of delaying the issuer's ability to offer its securities to the public and may cause the underwriter to withdraw. Thus, it is in the company's interest to resolve such questions promptly. If deficiencies are discovered after a registration statement has become effective, its effectiveness may be suspended 13/ and an investigation conducted by the Commission in which a registrant may testify voluntarily or be compelled to testify under oath. Further, company records may be subpoenaed, 14/ and members of the staff may make investigatory trips to the company's office to determine the facts. When deficiencies are discovered in either Securities Act registration statements or in registration statements or periodic reports under the Securities Exchange Act, trading in the company's stock may be suspended pending clarification or correction. 15/ Similarly, the registration of an investment adviser, investment company, or broker-dealer might be revoked or suspended should errors or omissions in a registration statement be discovered which warrant such action. 16/

In addition to its powers, by order, to suspend or revoke a registration statement as described above, the Commission may seek injunctions against further violations of the federal securities laws or the Commission's rules thereunder. 17/ Such actions might, in appropriate cases, be premised on violations of accounting requirements. Moreover, where violations of the securities laws are willful and sufficiently egregious, a criminal action may be instituted at the Commission's request by the Deparment of Justice. Criminal prosecution could result in either a fine or prison sentence against convicted parties.18/

Independent accountants engaged in practice before the Commission are required, under the ethical standards of the accounting profession and the Commission's rules, to conduct their audits of registrants' financial statements in accordance with generally accepted auditing standards. 19/

In any cases where there is evidence that an accountant has seriously departed from these professional standards, proceedings may be instituted against the accountant under Rule 2(e) of the Commission's Rules of Practice, 17 CFR 201.2(e). Such a proceeding might result in an accountant being barred or suspended from further practice before the Commission or might require that further practice only be conducted in accordance with conditions designed to insure the quality of the respondent's work. In one recent instance, for example, a national accounting firm was required to submit to review of its work by qualified independent persons. 20/

I hope that the above information will be of use in connection with the Subcommittee's review of the accounting responsibilities of federal agencies. Please feel free to contact me if I can be of further assistance.

Sincerely,

Rod M. Hills

Roderick M. Hills
Chairman

Enclosures

1/ The Securities Act of 1933, 15 U.S.C. 77a *et seq.*, requires, subject to certain exemptions, the registration of any public offering of securities. See 15 U.S.C. 77e. Section 7 of the Act, 15 U.S.C. 77g, and Schedule A, 15 U.S.C. 77aa, precribe the type of information required in Securities Act registration statements. Section 7 also provides, however, that the Commission has flexible powers to require additonal information, or to dispense with statutorily-specified disclosure requirements if it finds either action to be necessary or appropriate for the protection of investors or in the public interest.

The Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.*, requires, among other things and subject to certain exemptions, registration of any exchange-traded equity security or any security, held by more than 500 persons, of an issuer with over $1,000,000 in assets. See 15 U.S.C. 78*l*. The general nature of the information required in such a registration statment is described in Section 12(b) of the Act, 15 U.S.C. 78*l*(b).

The Public Utility Holding Company Act, 15 U.S.C. 79a, *et seq.*, has the effect of requiring, with certain exceptions, the registration of any company which owns or controls a public utility. See 15 U.S.C. 79b(7), 79d and 79e. The general content of a registration statement filed under that Act is described in Section 5(b), 15 U.S.C. 79e(b).

The Investment Company Act of 1940, 15 U.S.C. 80a-1, *et. seq.*, has the effect of requiring the registration of any investment company, as defined in Section 3 of that Act. See 15 U.S.C. 80a-3, 80a-7 and 80a-8. The general content of a registration statement filed under that Act is described in Section 8(b), 115 U.S.C. 80a-8(b)

2/ Sections 7, 19(a) and Schedule A, Items (25) and (26) of the Securities Act of 1933, 15 U.S.C. 77g, 77s and 77aa(25) and (26); Sections 12(b) and 13(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78*l*(b) and 78m(b); Sections 5(b), 14, 15 and 20 of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79e(b), 79n, 79*o* and 79t; Sections 8, 30(e), 31 and 38(a) of the Investment Company Act, 15 U.S.C. 80a-8, 80a-30(e), 80a-31 and 80a-38(a).

3/ As noted above, Section 12 of the Securities Exchange Act requires the registration of any company the securities of which are listed on a national securities exchange or which has over 500 shareholders, $1,000,000 in assets, and

4/ Section 17(e)(2) of the Securities Exchange Act, 15 U.S.C. 78q(e)(2), which was intended to govern financial reports required of brokers and dealers in securities who are registered with the Commission, but which was written in broader terms, provides:

> "The Commission, by rule, as it deems necessary or appropriate in the public interest or for the protection of investors, may prescribe the form and content of financial statements filed pursuant to this title and the accounting principles and accounting standards used in their preparation."

5/ Schedule A, Items (25) and (26), 15 U.S.C. 77aa(25) and (26).

6/ See Section 12(b)(1)(J) and (K) of the Securities Exchange Act, 15 U.S.C. 78l(b)(1)(J) and (K); Section 5(b)(2)(H) and (I) of the Public Utility Holding Company Act, 15 U.S.C. 79e(b)(2)(H) and (I); and Sections 8(b)(5) and 30(e) of the Investment Company Act, 15 U.S.C. 80a-8(b)(5) and 80a-30(e). The Commission has exercised this authority, and, in general, requires the certification of financial statements contained in Commission filings pursuant to the various securities laws. Form 10-K, the annual report of registrants under Section 12 of the Securities Exchange Act, is typical of these requirements. See Form 10-K, Instruction as to Financial Statements, Item 1. The text of the instructions to the various Commission forms constitute Commission rules. See 17 CFR 249.0-1(a). In contrast to Form 10-K, however, audited financial statements are nor required in the quarterly reports of registrants.

The Commission has also adopted a rule describing the conditions under which an accountant will be considered independent with respect to a particular client. See Rule 2-01 of Regulation S-X, 17 CFR 210.2-01.

7/ See Section 19(a) of the Securities Act, 15 U.S.C. 77s(a); Sections 3(b) and 23(a) of the Securities Exchange Act, 15 U.S.C. 78c(b) and 78w(a); Section 20(a) of the Public Utility Holding Company Act, 15 U.S.C. 79t(a); and Section 28(a) of the Investment Company Act, 15 U.S.C. 80a-37(a).

8/ Concerning the Commission's authority over the form, content, and preparation of such financial statements, see Section 17(e)(2) set forth in note 4 supra.

9/ There are some exceptions or variations in the authority and responsibilities discussed above applicable to certain classes of companies. For example, Section 101(c)

9/ (footnote continued)

of the Revenue Act of 1971, 85 Stat. 497, prohibits any federal agency from requiring adoption of a particular accounting method for the investment credit in reports subject to the agency's jurisdiction. This precludes the Commission from prescribing standards for accounting for the investment credit.

Section 503 of the Energy Policy and Conservation Act of 1975, 42 U.S.C. 6383, authorizes the Commission to assure the development and observation of accounting practices, which, among other things, enable the compilation of an appropriate energy data base, by companies engaged in the production of crude oil or natural gas. In carrying out its responsibilities under Section 503, the Commission is required to consult with the Federal Energy Administration, the General Accounting Office, and the Federal Power Commission. In addition, the Commission is explicitly authorized to rely on accounting practices developed by the Financial Accounting Standards Board (discussed in text _infra_, p. 8-9) if the Commission is assured that such practices will be observed to the same extent as if the Commission had prescribed such practices by rule.

Section 308 of the Railroad Revitalization and Regulatory Reform Act of 1976, 90 Stat. 56, amends both the Securities Act and the Securities Exchange Act to remove an exemption in prior law applicable to entities subject to the accounting requirements of other agencies which had precluded the Commission from requiring such entities to file reports with the Commission that were inconsistent with comparable reports filed with their regulatory commission.

10/ Regulation S-X appears in 17 CFR at Part 210. A copy of Regulation S-X is enclosed.

11/ Carman G. Blough, Comments in a Round Table on "Developments in Accounting Theory and Practice Since 1929," _American Institute of Accountants, 50th Anniversary Celebration_ at 190 (1937).

The Commission reaffirmed this policy with respect to pronouncements of the Financial Accounting Standards Board (described in the text _infra_) in Accounting Series

11/ (footnote continued)

Release No. 150 (December 17, 1973) wherein it stated, in part:

"In Accounting Series Release No. 4 (1938) the Commission stated its policy that financial statements prepared in accordance with accounting practices for which there was no substantial authoritative support were presumed to be misleading and that footnote or other disclosure would not avoid this presumption. It also stated that, where there was a difference of opinion between the Commission and a registrant as to the proper accounting to be followed in a particular case, disclosure would be accepted in lieu of correction of the financial statements themselves only if substantial authoritative support existed for the accounting practices followed by the registrant and the position of the Commission had not been expressed in rules, regulations or other official releases. For purposes of this policy, principles, standards and practices promulgated by the FASB in its Statements and Interpretations will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered to have no such support." (Footnotes omitted.) 3 SEC Docket 275,276 (1973).

12/ Section 8(c) of the Securities Act, 15 U.S.C. 77h(c), empowers the Commission to determine when, subsequent to the filing of an amendment to a registration statement, the statement shall become effective.

13/ Section 8(d) of the Securities Act, 15 U.S.C. 77h(d).

14/ Section 8(e) of the Securities Act, 15 U.S.C. 77h(e), 77s(b).

15/ Section 12(k) of the Securities Exchange Act, 15 U.S.C. 78l(k).

16/ The authority for these actions is contained in 15 U.S.C. 80b-3(e)(4) (investment adviser); 15 U.S.C. 80a-8(e) (investment company); 15 U.S.C. 78o(b)(4) (broker-dealer).

17/ See Section 20(b) of the Securities Act, 15 U.S.C. 77t(b); Section 21(d) of the Securities Exchange Act, 15 U.S.C. 78u(d); Section 18(f) of the Public Utility Holding Company Act, 15 U.S.C. 79r(f); Sections 36 and 42(e) of the Investment Company Act, 15 U.S.C. 80a-36 and 42(e); and Section 209(e) of the Investment Advisers Act, 15 U.S.C. 80b-9(e).

18/ Criminal penalties for violation of the federal securities laws are provided in Section 24 of the Securities Act, 15 U.S.C. 77x; Section 32 of the Securities Exchange Act, 15 U.S.C. 78ff; Section 29 of the Public Utility Holding Company Act, 15 U.S.C. 79z-3; Section 49 of the Investment Company Act, 15 U.S.C. 80a-48; and Section 217 of the Investment Advisers Act, 15 U.S.C. 80b-17.

19/ Rule 202 of the Code of Professional Ethics of the American Institute of Certified Public Accountants states:

> "A member shall not permit his name to be associated with a financial statement in such a manner as to imply that he is acting as an independent public accountant unless he has complied with the applicable generally accepted auditing standards promulgated by the Institute. Statements on Auditing Procedure issued by the Institute's committee on auditing procedure are, for purposes of this rule, considered to be interpretations of the generally accepted auditing standards, and departures from such statements must be justified by those who do not follow them."

Rule 2-02(b) of the Commission's Regulation S-X, 17 CFR 210.2-02(b), states:

> "The accountant's report (1) shall state whether the audit was made in accordance with generally accepted auditing standards; and (2) shall designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case, which have been omitted, and the reasons for their omission."

20/ In an opinion on a proceeding pursuant to Rule 2(e) of the Rules of Practice, announced in Accounting Series Release No. 173 (July 2, 1975), 7 SEC Docket 301 (1975), the Commission imposed sanctions on a large accounting firm which, among other things, required the firm to have an investigation made of its audit practices with respect to the financial statements of client-registrants of the Commission by a committee acceptable to the Commission, and promptly to adopt and implement any recommended corrective actions.
In addition, the firm was required to submit to reviews in 1976 and 1977 in conformity with the American Institute of Certified Public Accountants' program for the review of quality control procedures of multi-office firms to determine whether the firm had adopted and implemented

20/ (footnote continued)

certain procedures agreed upon in the proceedings and any corrective actions recommended in the prior investigation. Finally, the accounting firm was also required to conduct a study of a particular accounting technique--the percentage of completion method of recognizing income--which had been involved in the engagement which gave to the disciplinary proceeding in question. A copy of Accounting Series Release No. 173 is enclosed.

APPENDIX--LISTING OF ENCLOSURES

A. Securities Act of 1933, Sections 7, 8, 10 19(a) and Schedule A.

B. Securities Exchange Act of 1934, Sections 12, 13, 17 and 23(a).

C. Public Utility Holding Company Act of 1935, Sections 5(b), 14 and 20(a).

D. Investment Company Act of 1940, Sections 8, 30, 31(c) and 38(a).

E. Regulation S-X, 17 CFR pt. 210.

F. Rule 2(e) of the Commission's Rules of Practice, 17 CFR 201.2(e).

G. Accounting Series Release No. 173 (July 2, 1975).

(Staff Note: Appendix Item G mentioned above appears in the Peat, Marwick, Mitchell & Co. section of Appendix C of this study. The other enclosures referred to above are retained in the committee files except for Item F, which follows)

Appendix F -- Rules of Practice, Rule 2(e) [17 CFR 201.2(e)]

§ 201.2 Appearance and practice before the Commission.[1]

(e) *Suspension and disbarment.* (1) The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice of and opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws (15 U.S.C. secs. 77a to 80b–20), or the rules and regulations thereunder.

(2) Any attorney who has been suspended or disbarred by a Court of the United States or in any State, Territory, District, Commonwealth, or Possession, or any person whose license to practice as an accountant, engineer or other expert has been revoked or suspended in any State, Territory, District, Commonwealth, or Possession, or any person who has been convicted of a felony, or of a misdemeanor involving moral turpitude, shall be forthwith suspended from appearing or practicing before the Commission. A disbarment, suspension, revocation or conviction within the meaning of this subparagraph (2) shall be deemed to have occurred when the disbarring, suspending, revoking or convicting agency or tribunal enters its judgment or order, regardless of whether appeal is pending or could be taken, and includes a judgment or order on a plea of nolo contendere.

(3)(i) The Commission, with due regard to the public interest and without preliminary hearing, may by order temporarily suspend from appearing or practicing before it any attorney, accountant, engineer, or other professional or expert who, on or after July 1, 1971, has been by name:

(a) Permanently enjoined by any court of competent jurisdiction by reason of his misconduct in an action brought by the Commission from violation or aiding and abetting the violation of any provision of the Federal securities laws (15 U.S.C. secs. 77a to 80b–20) or of the rules and regulations thereunder; or

(b) Found by any court of competent jurisdiction in an action brought by the Commission to which he is a party or found by this Commission in any administrative proceeding to which he is a party to have violated or aided and abetted the violation of any provision of the Federal securities laws (15 U.S.C. secs. 77a to 80b–20) or of the rules and regulations thereunder (unless the violation was found not to have been willful).

An order of temporary suspension shall become effective when served by certified or registered mail directed to the last known business or residence address of the person involved. No order of temporary suspension shall be entered by the Commission pursuant to this subdivision (i) more than three months after the final judgment or order entered in a judicial or administrative proceeding described in (a) or (b) of this subdivision (i) has become effective upon completion of review or appeal procedures or because further review or appeal procedures are no longer available.

(ii) Any person temporarily suspended from appearing and practicing before the Commission in accordance with subdivision (i) of this subparagraph (3) may, within thirty days after service upon him of the order of temporary suspension, petition the Commission to lift the temporary suspension. If no petition has been received by the Commission within 30 days after service of the order by mail the suspension shall become permanent.

(iii) Within 30 days after the filing of a petition in accordance with subdivision (ii) of this subparagraph (3), the Commission shall either lift the temporary suspension or set the matter down for hearing at a time and place to be designated by the Commission or both, and after opportunity for hearing, may censure the petitioner or may disqualify the petitioner from appearing or practicing before the Commission for a period of time or permanently. In every case in which the temporary suspension has not

been lifted, every hearing held and other action taken pursuant to this subparagraph (3) shall be expedited in every way consistent with the Commission's other responsibilities.

(iv) In any hearing held on a petition filed in accordance with subdivision (ii) of this subparagraph (3), the staff of the Commission shall show either that the petitioner has been enjoined as described in subdivision (i)(*a*) of this subparagraph or that the petitioner has been found to have committed or aided and abetted violations as described in subdivision (i)(*b*) of this subparagraph and that showing, without more, may be the basis for censure or disqualification; that showing having been made, the burden shall be upon the petitioner to show cause why he should not be censured or temporarily or permanently disqualified from appearing and practicing before the Commission. In any such hearing the petitioner shall not be heard to contest any findings made against him or facts admitted by him in the judicial or administrative proceeding upon which the proceeding under this subparagraph (3) is predicated, as provided in subdivision (i) of this subparagraph. A person who has consented to the entry of a permanent injunction as described in subdivision (i)(*a*) of this subparagraph (3) without admitting the facts set forth in the complaint shall be presumed for all purposes under this subparagraph (3) to have been enjoined by reason of the misconduct alleged in the complaint.

(4) (i) An application for reinstatement of a person permanently suspended or disqualified under subparagraph (1) or (3) of this paragraph (e) may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown.

(ii) Any person suspended under subparagraph (2) of this paragraph (e) shall be reinstated by the Commission, upon appropriate application, if all the grounds for application of the provisions of that subparagraph are subsequently removed by a reversal of the conviction or termination of the suspension, disbarment or revocation. An application for reinstatement on any other grounds by any person suspended under subparagraph (2) of this paragraph (e) may be filed at any time and the applicant shall be accorded an opportunity for a hearing in the matter; however, such suspension shall continue unless and until the applicant has been reinstated by order of the Commission for good cause shown.

(5) Any person appearing or practicing before the Commission who has been the subject of an order, judgment, decree, or finding as set forth above shall promptly file with the Secretary of the Commission a copy thereof (together with any related opinion or statement of the agency or tribunal involved). Failure to file any such paper shall not impair the operation of any other provision of this paragraph (e).

(6) Any proceeding brought under any of the above subparagraphs shall not preclude a proceeding under any other subparagraph.

(7) All hearings held under this paragraph (e) shall be nonpublic unless the Commission on its own motion or the request of a party otherwise directs.

(f) *Contemptuous conduct.* Contemptuous conduct at any hearing before the Commission or a hearing officer shall be ground for exclusion from said hearing and for summary suspension without a hearing for the duration of the hearing.

(g) *Practice defined.* For the purposes of this rule, practicing before the Commission shall include, but shall not be limited to (1) transacting any business with the Commission; and (2) the preparation of any statement, opinion or other paper by any attorney, accountant, engineer or other expert, filed with the Commission in any registration statement, notification, application, report or other document with the consent of such attorney, accountant, engineer or other expert.

(h) *Service on attorneys.* In any proceeding where an attorney has filed an appearance pursuant to paragraph (d) of this section, any notice or other written communication required to be served upon or furnished to the client should also be served upon or furnished to the attorney (or one of such attorneys if the client is represented by more than one attorney) in the same manner as prescribed for his client, regardless of whether such communication is furnished directly to the client.

[25 F.R. 6723, July 15, 1960, as amended at 29 F.R. 4966, Apr. 9, 1964; 31 F.R. 5688, Apr. 13, 1966; 36 F.R. 6333, May 15, 1971]

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

26 April 1976

The Honorable Roderick Hills
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Hills:

As part of its study of Federal accounting practices, this subcommittee has been reviewing your commission's accounting series releases dealing with Rule 2 (e) proceedings on unprofessional behavior. The SEC has used this procedure 21 times since 1969 to discipline accountants. All of the disciplinary proceedings resulted from the failure of accountants and accounting firms to follow proper auditing procedures.

An evaluation of these accounting series releases raises certain questions regarding the Commission's enforcement procedures. For example, the individuals subject to disciplinary action were identified as well as the offending firms in all but seven of the cases. This is especially surprising in two of the omitted cases - Arthur Andersen and Peat, Marwick, Mitchell & Co. - because the individuals involved attempted to mislead the Commission in addition to other violations.

Accounting firms can only violate SEC regulations through actions by individuals. Individuals, especially professionals, must remain responsible for their actions. Disciplinary action is ineffective unless the responsible individuals and their violations are identified to the public. This was the procedure followed by the SEC in 14 of the cases involving individuals and smaller accounting firms.

There are also some noticeable discrepancies in the sanctions applied to violators by the Commission. The sanctions range from censure to permanent disqualification from practice before the SEC. Some individual accountants were permanently disqualified for single violations while Peat, Marwick, Mitchell & Co. was merely suspended from accepting new business for six months as a sanction for five serious violations.

In ASR 160 (Loux, Gose & Co. and Galen Lloyd Gose) and ASR 168 (Benjamin Botwinick & Co. and Alvin I. Mindes), the offending partners were identified and sanctioned along with the firms to which they belonged. However in ASR 144 (Laventhol, Krekstein, Horwath & Horwath), 153 (Touche Ross & Co.), 157 (Arthur Andersen & Co.), 167 (Westheimer, Fine, Berger & Co.), 173 (Peat, Marwick, Mitchell & Co.), 174 (Harris, Kerr, Forster & Co.), and 176 (Herty, Herson & Co.), only the firms were sanctioned. The individuals who caused the violations were not mentioned at all, even though the individuals in at least two cases repeated their unprofessional conduct in attempting to cover-up their original conduct.

In order that we may evaluate the disciplinary process under which the accounting profession operates, please provide the subcommittee with the following information:

1) an explanation of the sanctions which the SEC may use to discipline accountants, along with the guidelines followed by the SEC in applying sanctions;

2) the identities of all of the individuals whose conduct was responsible for the disciplinary actions against firms in ASR 144, 153, 157, 167, 173, 174, and 176; and

3) an explanation of the different treatment given to offenders in both the application of sanctions and the identification of individual violators.

Your cooperation in providing this information before 15 May will expedite this subcommittee's study of accounting matters.

Very truly yours,

Lee Metcalf

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

JUN 10 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on Reports
Accounting and Management of the
Committee on Government Operations
United States Senate
Washington, D.C. 20510

Dear Chairman Metcalf:

This is in response to your letter, dated April 26, 1976 concerning twenty-one of the Commission's accounting series releases dealing with suspension or disbarment proceedings instituted pursuant to Rule 2(e) of the Commission's Rules of Practice.

As indicated in my letter of acknowledgement, dated May 4, 1976, I referred your inquiry to Mr. Harvey L. Pitt, the General Counsel of the Commission, and asked him to look into the questions you asked. I have enclosed two copies of Mr. Pitt's report to me and hope you will find the report to be of assistance to the Subcommittee in its study of accounting matters.

Very truly yours,

Roderick M. Hills
Chairman

Enclosures

MEMORANDUM

June 8, 1976

TO: Roderick M. Hills
Chairman

FROM: Harvey L. Pitt HLP
General Counsel

RE: Letter from Senator Lee Metcalf, requesting certain information concerning proceedings involving accountants instituted pursuant to Rule 2(e) of the Commission's Rules of Practice

Introduction

Pursuant to your request, and with the assistance of the Division of Enforcement and the Office of the Chief Accountant, we have prepared this memorandum in response to questions asked by Senator Lee Metcalf in his letter, dated April 26, 1976, concerning twenty-one of the Commission's accounting series releases (hereinafter referred to as "ASR ____") dealing with certain proceedings suspending, temporarily or permanently, the privilege of accountants to appear or practice before the Commission, pursuant to Rule 2(e) of the Commission's Rules of Practice. 1/

The letter asked that you provide the Subcommittee with:

(1) an explanation of the sanctions which the Commission may use "to discipline" accountants in such proceedings;

(2) a listing of any guidelines the Commission may use in applying such sanctions;

(3) an explanation of the "different treatment" accorded respondents with respect to sanctions, particularly differences between the sanctions imposed on individuals and those imposed on large firms;

1/ 17 CFR 201.2(e). While this memorandum discusses Rule 2(e) proceedings involving accountants, as requested, it should be noted that Rule 2(e) also is applicable to proceedings brought against attorneys, engineers or other experts who may appear or practice before the Commission. Rule 2(g), 17 CFR 201.2(g).

(4) an explanation of the reasons why large accounting firms were named as respondents in seven specified proceedings, but the individuals involved were neither sanctioned nor identified; and

(5) the identities of the individuals involved in those proceedings.

The Commission's Enforcement Program

The Commission has limited resources with which it is expected, to the extent possible, to assure the investing public that the capital markets of this country are honest and free from fraud. The system of regulation through disclosure which characterizes most of the federal securities laws requires the active participation, assistance and diligence of members of the private sector, particularly lawyers and accountants. Ever since 1933, when Congress decided to rely upon independent public accountants to certify corporate financial statements in lieu of a corps of government auditors, the accounting profession has been an integral part of the regulatory scheme established by the federal securities laws. In recent years, the Commission has increased its focus in its investigative activities on certain key elements of the disclosure process, including the accounting profession, in the belief that a strengthening of the internal checks and balances that exist in that process will best serve the public interest.

In determining what action to take following the evaluation of the results of a staff investigation involving accountants, the Commission has available to it a variety of alternatives. It may authorize the filing of an injunctive action in which it seeks to have the persons whom it believes to have violated the securities laws in the past enjoined from further violations in the future; in aggravated instances, it may refer the files relating to the violations to the Department of Justice for possible criminal prosecution; and, finally, the Commission may take administrative action to deny permanently or temporarily the privilege of appearing or practicing before it pursuant to Rule 2(e) of the Commission's Rules of Practice. In this regard, the conduct which may give rise to a Rule 2(e) proceeding may also warrant the commencement of an injunctive action or a criminal proceeding, but this is not necessarily the case. Injunctive actions and criminal prosecutions are based on alleged conduct in violation of the law, while a Rule 2(e) proceeding may, in contrast, be based on charges that an accountant or other professional has engaged in unethical or improper professional conduct or is not fit to represent others before the Commission. Although Senator Metcalf's letter is concerned with the Commission's actions under Rule 2(e), it is important to understand that, in considering what action, if any, would be appropriate in a given set of circumstances, it con-

siders in each case the availability and utility of each of the alternatives indicated above. 2/

Let me emphasize at the outset that Rule 2(e) proceedings are remedial rather than punitive in nature. Thus, although such proceedings may have the effect of disciplining accountants and other professionals, the primary purpose of a Rule 2(e) proceeding is to protect the public by preventing a recurrence of the misconduct or other problems that led to the institution of such a proceeding, rather than merely holding persons accountable for what they have done in the past.

In the context of individual accountants, the goal is to provide a reasonable degree of assurance that the work of persons who appear and practice 3/ before the Commission will be competent and accurate. Rule 2(e) meets this goal by establishing a means of determining, if a question should arise, whether such persons have engaged in conduct inconsistent with the privilege of continued appearance or practice before the Commission, or whether they do not possess the requisite character and integrity to be allowed to continue to practice before the Commission.

2/ The Supreme Court's recent decision in Ernst & Ernst v. Hochfelder, 96 S. Ct. 1375 (Mar. 30, 1976), held that a private action for money damages would not lie against an accounting firm that was merely negligent as an aider and abetter of another person's deliberate fraud. The Court specifically left open the questions whether a Commission civil injunctive action also would be subject to the scienter requirement and whether aiding and abetting, long recognized by the lower courts, could suffice as the basis for imposing civil liability under the federal securities laws.

Pursuant to Senator Metcalf's request, we are preparing a detailed analysis of the Hochfelder decision. While the full implications of that decision are not yet known, and we have persuasive arguments against the imposition of the Hochfelder scienter standard in Commission enforcement actions, it may be appropriate for the Commission to place greater reliance upon Rule 2(e) in the future as a means of preventing a recurrence of unethical or improper conduct.

3/ While the term "practice before the Commission" is partially defined in Rule 2(g) of the Commission's Rules of Practice, the definition of the concept -- appearing and practicing before the Commission -- has received little attention. Nevertheless, in two recent court actions against attorneys who were alleged to have violated Rule 2(e) suspensions, the defendants were enjoined from engaging in a wide range of securities-related activities.

(footnote continued)

Where an individual accountant is found lacking in one of these respects, the remedial purpose of a Rule 2(e) proceeding may be achieved by depriving an accountant of the opportunity to injure investors again, either through a permanent or temporary suspension of the privilege of appearing or practicing before the Commission. In some cases, however, where the problems sought to be remedied result more from institutional deficiencies rather than individual failings, the goal may be achieved by other means, as set forth in more detail below.

3/ (footnote continued)

Thus in Securities and Exchange Commission v. Emanuel Fields, (S.D.N.Y.) No. 75 Civ. 1299 (LPG), the defendant consented to entry of an injunction which prohibited him:

(1) from representing or advising any person (a) in any proceeding or informal inquiry conducted by the Commission; (b) in any proceeding conducted or held by a national securities exchange or a national securities association; and (c) in conferences, discussions and other communications with the Commission or its staff except where these contacts are directly related to the conduct of court litigation or proceedings before any governmental department or agency other than the Commission;

(2) from preparing, or advising any person in connection with the preparation of, any statement, opinion, report or other document to be filed with the Commission;

(3) from representing or advising, in connection with any matter arising under or relating to the federal securities laws or the rules and regulations promulgated thereunder or the rules of a national securities exchange or a national securities association, any broker or dealer in securities, national securities exchange, or other regulated entity, except with respect to representation of such a regulated entity in court litigation or in proceedings before other government agencies; and

(4) from rendering, subject to certain exceptions, any advice, whether orally or in an opinion letter, concerning the legality of any act, transaction, or course of conduct under, the nature of any duty, obligation or liability imposed by, or the interpretation of, any provision of the federal securities laws or the rules and regulations promulgated thereunder or the rules of a national securities exchange or of a national securities association.

A similar settlement was reached in Securities and Exchange Commission v. Ezrine, (S.D.N.Y.) No. 72 Civ. 3161 (CBM).

Naturally, the scope of this concept necessarily is broader in the case of lawyers, but these cases do furnish some indication of the prohibitions that might ensue if an accountant is suspended from practicing before this Commission pursuant to Rule 2(e).

Rule 2(e)

Rule 2(e) provides that the Commission may permanently or temporarily deny the privilege of appearing or practicing before it to any person who is found, after notice and an opportunity for hearing

> (1) "not to possess the requisite qualifications to represent others";
>
> (2) "to be lacking in character or integrity or to have engaged in unethical or improper professional conduct"; or
>
> (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the federal securities laws or the rules and regulations promulgated by the Commission thereunder.

"Practice" before the Commission is defined by Rule 2(g) of the Commission's Rules of Practice to include, but is not limited to, "(1) transacting any business with the Commission; and (2) the preparation of any statement, opinion or other paper by any attorney, accountant . . . or other expert . . ." that is filed with the Commission with his or her consent.

Under certain circumstances, the Commission may suspend the right to practice of an individual pursuant to Rule 2(e) without a prior hearing. This may occur where some other forum has made a determination that the individual is, in effect, not fit to practice his profession or is a danger to the public. In these cases, the Commission relies on such findings rather than instituting de novo proceedings. Thus, Rule 2(e)(2) provides that any accountant, attorney or other expert

> "whose license to practice . . . has been revoked or suspended in any State . . . or any person who has been convicted of a felony, or of a misdemeanor involving moral turpitude, shall be forthwith suspended from appearing or practicing before the Commission."

In addition, Rule 2(e)(3) provides that the Commission may, without a preliminary hearing, temporarily suspend accountants and other professionals "from appearing or practicing before it" who have

> (a) been found by a court in an injunctive action brought by the Commission, or have been found by the Commission in an administrative proceeding, to have violated any provision of the federal securities laws; or

(b) been permanently enjoined by reason of their misconduct from violating any provision of the federal securities laws in an injunctive action brought by the Commission.

In all of the above cases, however, although the suspension may be ordered without a prior hearing, the Commission may provide a hearing subsequent to the suspension upon request of the person suspended. See Rule 2(e)(3)(b)(ii) and (iii) and Rule 2(e)(4)(i).

Practice of accountancy before the Commission is substantially carried on in the form of large accounting firms. Such firms have an obligation as practicing entities to design adequate quality control and review procedures. The involvement of a large accounting firm in a Rule 2(e) proceeding thus creates special problems in the fashioning of appropriate remedies. The problems which have come to the attention of the Commission during private investigations involving such firms have involved a small proportion of their personnel of these firms. Very often, the shortcomings which led to the institution of a proceeding were rooted in poor supervision by persons with positions high in the firm, lack of adequate quality controls or insufficient enforcement of those controls that existed. In some instances, personnel whose training was not commensurate with the complexity of the task undertaken were required by the firm to assume responsibility beyond their competence.

In such circumstances, where the problems sought to be remedied appeared to result more from organizational defects than wrongdoing on the part of particular individuals, the Commission has deemed it appropriate to name accounting firms as respondents in proceedings instituted under Rule 2(e). In certain of these cases, the Commission has also recognized, for essentially the same reasons, that it was not necessary to name individual accountants as respondents to accomplish the remedial purposes of a Rule 2(e) proceeding. In addition, the Commission has recognized that, in such circumstances, to bar a large accounting firm from all appearance or practice before the Commission either temporarily or permanently would have the effect of penalizing many individuals whose conduct was in no way culpable or responsible for the problems which led to the proceeding and would require the clients of those firms to seek new independent accountants.

Rule 2(e) provides a flexible format which the Commission has utilized to fashion remedies which are appropriate to the circumstances involved in such situations. For example, in certain instances the Commission has required that there be an investigation by a qualified group of outside professionals, at the respondent accounting firm's expense, designed to review and make recommendations with respect to the firm's overall practice. 4/ The Commission believes that such remedies provide some assurance that the problems encountered in large accounting firms will be remedied and that the overall practice of such firms will be improved. The reform of

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4/ See, *e.g.*, ASR 173.

control procedures within a firm, where appropriate, tends to minimize the possibility of a recurrence of the problems which led to the institution of Rule 2(e) proceedings. In addition, limitations on the growth of a firm's practice before the Commission for a period of time tend to insure that such growth will not impair the quality of the firm's work while more adequate control procedures are being implemented. Although we have had limited experience with such remedies to date, we believe that they are a promising means of dealing with the problems which have arisen in a large firm context.

Guidelines; Remedies

In determining the appropriate remedy in a particular case, the Commission does not have a precise set of guidelines to follow. Rather, each proceeding is considered on a case-by-case basis which takes into account all of the relevant circumstances. 5/ These circumstances may include:

(1) the gravity of the misconduct or other professional deficiency involved;

(2) whether the misconduct or deficiency arose in connection with appearing or practicing before the Commission;

(3) whether the problems which led to the proceeding appear to result more from institutional faults than individual failings;

(4) the degree to which the misconduct or other deficiency casts doubt upon an individual's ability or willingness to perform competent and reliable professional services in the future;

(5) whether the individual or firm involved has been the subject of any previous enforcement action or Rule 2(e) proceeding brought by the Commission;

5/ In the analogous context of administrative proceedings involving brokers or dealers, the courts have recognized that the imposition of sanctions is a matter entrusted to the discretion of the Commission, dependent upon an evaluation of all of the facts and circumstances of a case, and that a Commission determination in this regard may not be challenged by comparing the remedies imposed in one case with those imposed either in other cases or against other respondents in the same case. Cf. Dlugash v. Securities and Exchange Commission, 373 F.2d 107 (C.A. 2, 1967); Hiller v. Securities and Exchange Commission, 429 F.2d 856 (C.A. 2, 1970).

(6) the experience of the Commission's staff in conducting the investigation which led to institution of a proceeding; and

(7) other similar considerations.

The most important question, however, is whether the remedies are necessary or appropriate for the protection of investors by preventing a recurrence of the problems which led to institution of the proceedings under Rule 2(e). It is the interplay of all of these factors which accounts for the differences in the sanctions referred to in Senator Metcalf's letter.

Individuals

We have already indicated reasons why the Commission has, on occasion, named large accounting firms as respondents in Rule 2(e) proceedings, and obtained relief against such firms, while specific individuals in the firm were neither identified nor sanctioned. As noted, where the problems which gave rise to a proceeding appeared to arise more from institutional faults than individual wrongdoing, it could be unfair or unnecessary to take action against individuals to prevent a recurrence of the same problems. Since no individual accountants were named as respondents in the seven proceedings enumerated in Senator Metcalf's letter, there has never been an adjudication of any individual's responsibility or culpability, if any, with respect to the conduct attributed to the firm in these proceedings. For these reasons, I am concerned that it might be inappropriate to disclose the identities of the individuals whose conduct may have been related to the problems involved in those proceedings, who were not named in any proceeding. Naturally, we will be happy to discuss this matter with Senator Metcalf further, if that should be desirable.

I should note, however, that, with respect to three of the seven proceedings under Rule 2(e) in which no individual accountants were named 6/ the firms involved were also named as defendants in a total of six related injunctive actions brought by the Commission. In addition, in two injunctive actions related to the proceedings reported in ASR Nos. 144 and 173, five individuals were named as defendants. Those persons were: (a) Morton Dear, Robert E. Bier and Thomas Martino, Jr. 7/ and (b) Anthony M. Natelli and Joseph Scansaroli. 8/ Moreover, criminal prosecutions related to those

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6/ ASR Nos. 144, 167 and 173.

7/ Securities and Exchange Commission v. Everest Management Corp., S.D.N.Y., No. 71 Civ. 4932.

8/ Securities and Exchange Commission v. National Student Marketing Corp., et al., (D.D.C.) No. 225-72 (MDL No. 105).

same proceedings were brought against four individuals, including two who were not named as defendants in the injunctive actions, and all four individuals were initially convicted. These individuals were: (a) Jerome E. Silverman and Phillip Zane 9/; and (b) Anthony M. Natelli and Joseph Scansaroli (the latter's conviction was subsequently reversed and remanded for a new trial) 10/. As indicated earlier, suspension from practice before the Commission may follow as a result of such court actions. In this regard, Messrs. Silverman, Zane and Natelli have, in fact, been disqualified from appearing or practicing before the Commission on the basis of their criminal convictions.

We hope that this information will be helpful to the Subcommittee in its study of accounting matters. Please let me know if we can be of further assistance.

HLPitt - 51108
PGonson - 51178
FBWade - 51286

JCBurton - 51180
LFeller - 51180

TSonde - 55724
RSharp - 54876

9/ United States v. Persky, S.D.N.Y., 73 Cr. 192 affirmed sub. nom.; United States v. Zane, 495 F.2d 683 (C.A. 2) certiorari denied, 419 U.S. 895 (1974).

10/ United States v. Natelli (S.D.N.Y.), 74 Cr. 43, affirmed in part and reversed in part, 527 F.2d 311 (C.A. 2, 1975), certiorari denied. 44 U.S. Law Week 3587 (1976).

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

19 May, 1976

Honorable Roderick Hills
Chairman
Securities and Exchange Commission
Washington, D. C. 20549

Dear Chairman Hills:

As part of its review of Federal accounting practices, this subcommittee has noted the 30 March, 1976 decision of the United states Supreme Court in Ernst & Ernst v. Olga Hochfelder. In that case, the Court held that "scienter" -- the intent to deceive, manipulate, or defraud -- is a necessary requirement of any private action for damages under the fraud provisions of the securities laws. This decision apparently overrules previous case law which had allowed private actions for damages in cases where fraud had been accomplished through simple negligence.

The simple negligence standard had evolved because the securities laws are remedial legislation for the purpose of protecting innocent investors. Investors suffer the same amount of damages through fraudulent acts whether they are intentional or are the result of negligence.

The Hochfelder decision states that an accounting firm can only be held liable for damages when it intentionally approves fraudulent acts or information that harms investors. Under the Hochfelder standard, accountants may perform negligent audits and issue negligent opinions which cause great harm to investors who must rely upon the integrity and independence of the accountant. A standard of care excusing all but intentional deception is inappropriate for a profession

charged with issuing independent and sound judgments on the reliability of information upon which the impersonal investment markets must depend.

As chairman of the subcommittee charged with promoting sound accounting practices, I am concerned over the implications of the Hochfelder decision. Our review of accounting abuses has shown that standards governing the auditing of publicly held corporations should be strengthened, not weakened. Furthermore, this decision imperils the success of private damage suits for securities fraud by setting an absurdly lax standard of care for accountants. Private actions for damages have been instrumental in the enforcement and prevention of securities fraud, thus reducing the regulatory burden on the Commission while providing relief to those who deserve it.

In his dissent to the Hochfelder decision, Justice Blackmun was joined by Justice Brennan in the following language:

> In this light, the initial inquiry into whether Ernst & Ernst's preparation and certification of the financial statements of First Securities Company of Chicago were negligent, because of the failure to perceive Nay's extraordinary mail rule, and in other alleged respects, and thus whether Rule 10b-5 was violated, should not be thwarted.
>
> But the Court today decides that it is to be thwarted; and so once again it rests with Congress to rephrase and to re-enact, if investor victims, such as these, are ever to have relief under the federal securities laws that I thought had been enacted for their broad, needed, and deserving benefit.

In view of the fact that the Commission filed an amicus curiae brief in support of retaining the negligence standard for determining fraud under the

the securities laws, please provide this subcommittee with an analysis of the Hochfelder decision, its impact on accounting standards and securities fraud, and the actions which should be taken by Congress to restore protection against negligent fraud to investors.

As we are operating under time constraints in our review of accounting practices, I ask your cooperation in providing a response by 28 May. Any questions concerning this request should be directed to subcommittee counsel Jack Chesson at 224-1474.

Very truly yours,

Lee Metcalf

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

August 27, 1976

The Honorable Lee Metcalf
Chairman
Subcommittee on Reports,
Accounting and Management
Senate Committee on
Government Operations
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

I am writing in response to your request that the Commission supply the Subcommittee with certain information pertaining to the ramifications of the Supreme Court's decision in Ernst & Ernst v. Olga Hochfelder, et al., 96 Sup. Ct. 1375 (Mar. 30, 1976).

I very much regret the delay in forwarding our response. However, as I am sure you appreciate, the issues involved here are complex and far-reaching. The delay has been occasioned not by any tardiness in addressing your request, but rather by the amount of time required for detailed and comprehensive examination by several offices within the Commission of the immediate and long-term effects of the Hochfelder decision.

Your letter asked the Commission to supply analyses of the decision and of its impact on accounting standards and securities fraud, and suggestions for Congressional action. The attached memorandum, prepared pursuant to your request, will I hope provide the analyses you seek.

The Commission is not in a position, at this time, to recommend specific legislative action. We have not, in fact, yet determined whether it would be necessary to seek new legislation at this time as a result of the Hochfelder decision. However, you may be sure that our staff will continue to study the effect of this decision on the right of investors to recover losses occasioned by fraud, as well as on the Commission's enforcement program.

I hope this information will be helpful to you, and that you will not hesitate to contact me if I can be of further assistance in this, or any other matter.

Sincerely,

Rod M. Hills

Roderick M. Hills
Chairman

MEMORANDUM

April 26, 1976

TO: All Staff Attorneys

FROM: Office of the General Counsel

RE: Ernst & Ernst v. Hochfelder, No. 74-1042 (U.S. Mar. 30, 1976).

In Ernst & Ernst v. Hochfelder (copy attached), where an accounting firm was alleged to have negligently aided and abetted a broker-dealer's violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, the Supreme Court held that a private cause of action for civil money damages will not lie under Section 10(b) and Rule 10b-5 in the absence of an allegation of "scienter, which the Court defined as an "intent to deceive, manipulate, or defraud" (slip op. p. 7). In view of this holding, the Court expressly declined to consider "whether civil liability for aiding and abetting is appropriate under the section and rule [and, if so, what are] the elements necessary to establish such a cause of action" (slip op. p. 5 n. 7). In addition, the Court did not address "the question whether, in some circumstances, reckless behavior is sufficient for civil liability under Section 10(b) and Rule 10b-5," although it recognized that "in certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act" (slip op. p. 7 n. 12).

With respect to injunctive actions, the Court noted that "since this case concerns an action for damages we also need not consider the question whether scienter is a necessary element in an action for injunctive relief under Section 10(b) and Rule 10b-5. Cf. S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963)" (slip op. p. 7-8 n. 12). Thus, while the Court left open the issue of the necessity of proving "scienter" in Commission actions for violations of Section 10(b) and Rule 10b-5, it should be noted that the Court repeatedly remarked that it did not regard Section 10(b) as proscribing conduct that is merely negligent. In this connection, the Court examined the language of the section and stated that use of the terms "manipulative," "device", and "contrivance" "make unmistakeable a congressional intent to proscribe a type of conduct quite different from negligence" (slip op. p. 12). Similarly, the Court's analysis of the relevant portions of the Securities Exchange Act's legislative history led it to the conclusion that "§10(b) was addressed to practices that involve some element of scienter and cannot be read to impose liability for negligent conduct alone" (slip op. p. 14). 1/ Later, the Court again

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1/ At p. 15 of its slip opinion, the Court observed that "there is no indication [in the legislative history] . . . that §10(b) was intended to proscribe conduct not involving scienter."

concluded:

> "When a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances -- the commonly understood terminology of intentional wrongdoing -- and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct." (slip op. p. 27). 2/

The Hochfelder decision clearly will have an impact upon pending and future Commission injunctive actions. 3/ As a consequence, we

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2/ In its discussion of Rule 10b-5 (slip op. pp. 24-27) the Court noted that the Rule was adopted pursuant to the power granted the Commission under Section 10(b), and, as a consequence, the scope of the Rule could not exceed the power granted to the Commission by Congress under that statutory section.

3/ In Securities and Exchange Commission v. Geotek Resources Fund, Inc., et al., No. C-73-819-WTS (N.D. Cal.), for example, Judge Sweigert, in issuing an oral opinion with respect to certain of the defendants in that action, stated (Transcript, p. 30):

> "The Supreme Court in the Ernst action, indicated that even ordinary negligence, ordinary care, that is, failure to exercise ordinary care, would be insufficient in a private Federal Securities Act case.
>
> "We doubt, therefore, that slight negligence, that is failure to use extreme care, would be held sufficient even in an SEC enforcement case."

Judge Sweigert continued:

> "The degree of culpability required to establish a violation of the Federal Securities Act in an SEC enforcement action such as this has been almost uniformly established among the circuits to be negligence, or the lack of due diligence."
>
> . . .
>
> "Since the Supreme Court has left this question of culpability open in statutory enforcement actions, we have applied in this pending case the relatively strict standard of negligence, failure to use ordinary care."

We are presently awaiting receipt of a copy of Judge Sweigert's memorandum opinion in Geotek in order to review his written articulation of the standard of culpability in Commission injunctive actions.

have set forth some initial observations in this memorandum with respect to the Hochfelder decision relevant to resisting defense counsels' efforts to avoid having their clients enjoined from future violations of the federal securities laws. The full impact and meaning of this decision is not clear, although we are confident that the case is not going to be of help to any of us in the forseeable future. If you have any Commission cases in which the Hochfelder issue is raised, please notify Harvey Pitt or Paul Gonson, at (202) 755-1108 or (202) 755-1178, respectively, no later than Friday, May 21, with a list of such cases. Naturally, for the immediate future, we wish to be of assistance to you in resolving any motions or other pleadings or papers raising Hochfelder issues. We ask that you keep in touch with us, so that we may coordinate all responses to such charges.

Although the Supreme Court in Hochfelder specifically left open the question whether scienter is a necessary element in a Commission action to enjoin violations of Section 10(b) and Rule 10b-5 (slip op. p. 7-8, n. 12), in light of various other statements made by the Court in that opinion it appears reasonable to expect that defense counsel will employ the Hochfelder decision as the touchstone for arguments that the Commission must also allege and prove scienter, as the Court has defined that term, in order to obtain injunctive relief for violations of the section and the rule.

For example, defense counsel may be expected to focus upon statements by the Court such as "there is no indication . . . that §10(b) was intended to proscribe conduct not involving scienter" (slip op. p. 15) and that "there is no indication in the administrative history of the Rule [10b-5] that any of the subsections was intended to proscribe conduct not involving scienter" (slip op. p. 26 n. 32). In this connection, counsel might argue that, if there is no indication that the statutory section or the rule promulgated thereunder were intended to proscribe conduct not involving scienter in the context of private action for damages, then the same reading of the scope of the statute and the rule is applicable in Commission actions for injunctive relief. 4/

In our view, however, the Supreme Court's addition in Hochfelder of "scienter" to the elements necessary to establish a private cause of action under Section 10(b) and Rule 10b-5, which evidences the Court's

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4/ It should be noted that the Commission stated in its Hochfelder brief at pp. 8, 16-17, in the Supreme Court, when speaking of negligent conduct, that the determination of whether particular conduct violates Section 10(b) and Rule 10b-5 should not depend upon the identity of the plaintiff. In his dissent, Mr. Justice Blackmun repeats this argument (slip op. p. 3). Thus, defense counsel may argue that this statement strongly suggests that the same standard of culpability should exist both in private and Commission actions.

disinclination to subject professionals to potentially enormous civil money damage liability, should not be construed as necessarily carrying over into Commission actions for injunctive relief for violations of that statutory provision and that rule. At the outset we suggest arguing in opposition to reliance upon Hochfelder for the proposition that scienter should be a necessary element in Commission injunctive actions, that Hochfelder, a private damage action, is significantly distinguishable from Commission actions. As we have previously noted, in Hochfelder the plaintiffs sought civil money damages from an accounting firm, whereas Commission actions seek to protect the public by enjoining violations of the federal securities laws.

In this connection we would contrast Commission actions where we protect investors and the public by seeking injunctions against future violations of the federal securities laws with private civil actions, which seek to redress victims with money damages for past violations. Thus, in view of the differing policies and purposes underlying Commission actions and private actions under the federal securities laws, it is arguable that a lesser showing of culpability is required in Commission actions in order to obtain relief than private actions. 5/

Consistent with the distinction between private actions which seek to redress past conduct by money damages and Commission actions which seek to prevent future violations of law, it may be possible to argue in particular cases (when other arguments, which we discuss below, prove unavailing) that it is not necessary in order to obtain an injunction that we establish a past violation of law. Our statutes which authorize injunctive actions do not require a past violation; rather, they provide that we may seek to enjoin where the defendant is violating or is about to violate. In our cases we generally have sought to establish past violations not for their own sake, but as a basis for arguing that the court should draw an inference from the past violation that the defendant, unless enjoined, is likely to violate again in the future. 6/

5/ Decisions of the Court of Appeals for the Second Circuit have recognized this distinction, holding that a showing of negligence is sufficient for the Commission to obtain injunctive relief while private plaintiffs are required to prove the defendants' conduct was more culpable than merely negligent in order to recover money damages. S.E.C. v. Management Dynamics, Inc., 515 F.2d 801 (C.A. 2, 1975); S.E.C. v. Spectrum, Ltd., 489 F.2d 535, 541 (C.A. 2, 1973); S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d 833, 854-855 (C.A.2, 1968) certiorari denied 394 U.S. 976 (1969). We would argue that this is still good law.

6/ To illustrate this point further, there have been occasions when a court was satisfied that the Commission had established the past violation of law, but nevertheless refused to issue an injunction because it did not believe there was a likelihood of future violation.

Depending on the facts in a particular case, we might argue that notwithstanding that the court is of the view that the conduct of the defendant was merely negligent and, under Hochfelder, not a violation of Section 10(b), it still remains a proper basis for drawing an inference that such conduct may continue into the future. That conduct, while perhaps merely negligent in the past, has now been called forcefully to the defendant's attention. Now warned, should the defendant continue his activities with the same disregard for proper adherence to professional or industry standards, the same conduct may no longer be characterized as merely negligent. Rather, it may well be said to be reckless. And recklessness, as we discuss in the next paragraph, may be a sufficient basis to meet the scienter requirement.

In leaving open the question of whether scienter is a necessary element in an injunctive action, the Court referred to Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). 7/ It bears emphasis that the Supreme Court remarked in Capital Gains both that "it is not necessary in a suit for equitable or prophylactic relief to establish all the elements in a suit for money damages," (id. at 193) and that the securities laws should be interpreted flexibly, rather than technically and restrictively, in order to effectuate their remedial purposes of avoiding fraud." Id. at 195. In the context of these pronouncements in Capital Gains, coupled with the Court's statement in Hochfelder that the relevant portions of the Securities Exchange Act's legislative history support the "conclusion that §10(b) was addressed to practices that involve some element of scienter (slip op. p. 14) (emphasis added), it appears that we could make a strong argument that a showing of recklessness would be sufficient in Commission injunctive actions. As we have previously noted, in Hochfelder the Court remarked that in some areas of the law recklessness is considered to be a form of intentional conduct. In this regard it is important to note that the facts underlying Hochfelder demonstrate that the plaintiffs in that action neither saw nor relied upon defendant Ernst & Ernst's work product. In addition, Ernst & Ernst could not reasonably forsee that these plaintiffs would rely on its work product. Thus, the Hochfelder factual pattern can be contrasted, perhaps successfully, to Commission injunctive actions where evidence may exist that securities fraud victims either saw or relied upon the defendants' work product or statements and the defendants could reasonably forsee or be expected to forsee such reliance by the victims.

When faced with the prospect of attempting to minimize the impact of Hochfelder on present or future enforcement actions, in addition to asserting the above-mentioned arguments, Commission counsel might treat Hochfelder as the most recent of a line of Supreme Court decisions

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7/ The Court in Capital Gains at 193 recognized that the content of common law fraud has not remained static, but has varied with, inter alia, the nature of the relief sought and the relationship between the parties.

which emphasize the Court's determination to cut back on the proliferation of federal court remedies and, in general, to reduce the increasing workload on the federal court system. Such concerns go to private actions, especially class and derivative suits. Federal agency law enforcement is quite different, in this context. Several recent Supreme Court cases have distinguished private plaintiffs from the Commission as plaintiff in suits commenced under the federal securities laws. For example, in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), the Court upheld the Birnbaum rule which provides that the plaintiff must be a purchaser or seller of securities in order to institute a private action for damages under Section 10(b) and Rule 10b-5. But, at the same time, the Court in Blue Chip affirmed an earlier opinion holding that the purchaser-seller rule did not impose a limitation on the Commission's standing to institute injunctive actions for violations of that statutory section and the Rule (421 U.S. at 752, n. 14).

Similarly, in Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 57-65 (1975), the Court went to great lengths to emphasize that a private plaintiff which brought an action to enjoin violations of Section 13(d) of the Securities Exchange Act was not relieved of the burden of showing irreparable injury and the other traditional prerequisites for obtaining injunctive relief, such as the inadequacy of legal remedies. Although the Court in Rondeau did not discuss Commission actions brought to enjoin violations of the securities law it is clear that the Rondeau decision was directed to "private litigants" and "competing private interests." Yet, it is well established that the Commission, as the agency authorized by statute to institute actions to enjoin violations of the federal securities laws, need not prove all the necessary elements requisite for a private party to obtain injunctive relief. 8/ And, as we have previously noted, the Court in Hochfelder limited its holding to private actions for civil damages under Section 10(b) and Rule 10b-5 while leaving open the question of scienter as a necessary element in a Commission action.

Thus, in our view, a view shared by several commentators, Blue Chip, Rondeau and Hochfelder evidence a trend in the Supreme Court to limit access by private parties to the federal courts. Blue Chip and Hochfelder limited the class of plaintiffs who can institute private actions for violations of the federal securities laws, while Rondeau restricts the availability of injunctive relief to private plaintiffs for violations of the federal securities laws by requiring a showing of elements such as irreparable injury and the inadequacy of legal remedies. In addition, Alyeska Pipeline Service Co. v. Wilderness Society, 421

8/ S.E.C. v. Management Dynamics, 515 F.2d 801, 808 (C.A. 2, 1975), and cases and authorities cited therein.

U.S. 240 (1975), and Cort v. Ash, 422 U.S. 66 (1975), two cases not involving the federal securities laws, also indicate the Supreme Court's attitude of restricting access to the federal courts. In the Alyeska Pipeline case the Court severely limited those instances where a district court may award private plaintiffs attorneys' fees, thus cutting back on the "private attorney general" concept of J. I. Case Co. v. Borak, 377 U.S. 426 (1964). And in Cort v. Ash, where the plaintiff sought to allege a private claim for relief under a statute which prohibited illegal corporate campaign contributions, the Court held that it would not imply a private cause of action under such a statute.

Significantly, in each of these recent cases involving the federal securities laws and other statutes the Supreme Court has not expressly limited access to the federal courts by the Commission or other federal agencies. In fact, in the securities laws cases the Court appears to have carefully articulated its holdings so as to either carve out exceptions for the Commission or to leave open certain issues which pertain to Commission actions. While it may be difficult in pending enforcement actions to argue in a broad sense that Hochfelder is the most recent of the Supreme Court cases which affect private actions under the federal securities laws but not Commission actions, especially in light of some of the language in that opinion, we suggest this approach as a secondary line of argument which may be viewed favorably by federal judges.

Since the Court in Hochfelder specifically left open the issue of whether "scienter" is an element in injunctive actions as well as the issue of whether in some circumstances recklessness should be considered as intentional conduct, we suggest that future complaints in injunctive actions not contain unnecessary allegations of either scienter or recklessness. Instead, we believe that complaints should be drafted to allege that defendants "violated " rather than alleging that the defendants "knowlingly," "wilfully" or "recklessly" violated the statutes. Of course, in those instances where the staff possesses evidence which would support a finding of willfulness, recklessness or knowledge, we suggest that the complaint allege that the defendants "knew or should have known." In our view, drafting complaints in this fashion will provide the staff with flexibility in proving its case without, at the same time, risking the possibility that we may be required to meet a more difficult standard of scienter by pleading, for example, "willfulness" or "knowledge." 9/

9/ In the Commission's action against Bangor Punta Corp., it was was alleged that Bangor-Punta had a "propensity or natural inclination" to violate, inasmuch as Bangor-Punta had previously been enjoined from violating the securities laws. The district court held that we had not established "propensity or natural inclination" to violate, found that there was no violation by Bangor-Punta, and denied the issuance of an injunction. On appeal, the Court found a violation

(footnote continued)

Additionally, if possible and particularly where our proof of knowledge is slim, we suggest that the staff avoid "aiding and abetting" allegations and instead allege that a defendant "directly or indirectly" violated the statute or that a defendant "participated" in a violation, since the Court in Hochfelder (slip op. p. 5 n. 7) declined to consider whether civil liability for aiding and abetting is appropriate under Section 10(b) and Rule 10b-5 or the elements necessary to establish such a cause of action. In all likelihood, defense counsel will focus upon this footnote and attempt to formulate arguments that "aiding and abetting" is inappropriate in Commission actions. Naturally, we wish to be apprised of all pending "aiding and abetting" cases, too.

As a final matter, we recommend, whenever possible, that the staff include allegations of violations of statutory provisions and rules in addition to Section 10(b) and Rule 10b-5 allegations, and particularly Section 17(a) of the Securities Act, which may not be subject to the "scienter" requirements of Section 10(b). Thus, if a court interprets Hochfelder in a manner hostile to the Commission, allegations of other statutory violations will still provide the court with an alternate basis upon which to find a violation and to issue an injunction.

Attachment

HLPitt - 51108
PGonson - 51178
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9/ (footnote continued)

by Bangor-Punta but affirmed the district court's denial of an injunction. There was a difference of view among the panel judges whether "propensity or natural inclination" to violate was a stricter standard than "a reasonable likelihood of future violations," requiring some showing of scienter. We had intended merely to make an *a fortiori* argument. Our petition for certiorari was denied. S.E.C. v. Bangor-Punta Corp., 480 F.2d 341 (C.A. 2), *certiorari denied*, 414 U.S. 924 (1973).

Office Memorandum • SECURITIES AND EXCHANGE COMMISSION

DATE: August 27, 1976

TO : Roderick M. Hills
Chairman

FROM : Harvey L. Pitt
General Counsel

SUBJECT: Analysis of the decision of the Supreme Court in Ernst & Ernst v. Hochfelder, 96 S. Ct. 1375 (Mar. 30, 1976).

Introduction

Pursuant to your request, and with the assistance of the Division of Enforcement, we have prepared this memorandum in response to the May 19, 1976, letter from Senator Lee Metcalf, Chairman of the Subcommittee on Reports, Accounting and Management of the Senate Committee on Government Operations regarding the recent Supreme Court decision in Ernst & Ernst v. Olga Hochfelder, 96 S. Ct. 1375 (Mar. 30, 1976).

Discussion

I. The Hochfelder Decision

A. The law prior to Hochfelder -- a split in the circuits

In Hochfelder, the Supreme Court held that a private cause of action for damages will not lie under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5, in the absence of any allegation of "scienter", which the Court defined to mean an "intent to deceive, manipulate, or defraud." 1/ Prior to the

1/ 96 S. Ct. at 1381. In defining scienter in this fashion, the Court adopted a more stringent test of scienter than had existed at common law for traditional fraud actions. See 1 Harper & James, The Law of Torts, §7.3 at 532 ("'Scienter' is used to describe the state of mind which makes false misrepresentations fraudulent.")

Hochfelder decision, the federal courts of appeals differed as to whether negligence alone was sufficient for money damage liability under Section 10(b) and Rule 10b-5 or whether the breach of some higher standard of care was a necessary element of such a cause of action. 2/

Thus, in White v. Abrams, 495 F.2d 724 (1974), the Court of Appeals for the Ninth Circuit rejected the use of labels such as "negligence" and "scienter" and instead adopted a "flexible duty" standard which, in certain circumstances, would permit the imposition of liability for negligent conduct. The White decision provided in pertinent part (id. at 734-735):

> "[W]e reject scienter or any other discussion of state of mind as a necessary and separate element of a 10b-5 action. The proper standard to be applied is the extent of the duty that rule 10b-5 imposes on this particular defendant." 3/

The Ninth Circuit in White continued (id. at 735-736):

> "[T]he court . . . should require the jury to consider the relationship of the defendant to the plaintiff, the defendant's access to the information as compared to the plaintiff's access, the benefit that the defendant derives from the relationship, the defendant's awareness of whether the plantiff was relying upon their relationship in making his investment decisions and the defendant's activity in initiating the securities transaction in question." (Footnotes omitted) 4/

2/ See discussion, 96 S. Ct. at 1381, n. 12.

3/ The decision of the Court of Appeals in Hochfelder, discussed infra, also proceeded from a "duty" analysis.

4/ Later Ninth Circuit decisions adhered to the "flexible duty" standard of the White case; see Clark v. Watchie, 513 F.2d 994 (1975), certiorari denied, 96 S. Ct. 72 (Oct. 6, 1975), and Robinson v. Cupples Container Co., 513 F.2d 1274 (1975).

The Seventh Circuit (the court which was reversed by the Supreme Court in Hochfelder) stated in Tomera v. Galt, 511 F.2d 504, 508 (1975), that "Rule 10b-5 claimants need not plead nor prove scienter." 5/ Similarly, two decisions of the Court of Appeals for the Eighth Circuit had rejected the requirement of scienter under Seciton 10(b) and Rule 10b-5 and stated that negligence would be sufficient to support liability. City National Bank v. Vanderboom, 422 F.2d 221 (1970), and Vanderboom v. Sexton, 422 F.2d 1233 (1970). 6/

The Second Circuit, however, in Lanza v. Drexel & Co., 479 F.2d 1277, 1306 (1973), held that "mere negligence" is not enough to support a private cause of action under Section 10(b) and that "proof of a willful or reckless disregard for the truth is necessary to establish liability under Rule 10b-5." 7/ Similarly, the Tenth Circuit remarked that it "has repeatedly declined to extend the [federal securities] acts to cases of simple negligence not involving some fraudulent purpose or species of scienter within their scope and purpose" and that it requires "something additional by way of scienter or conscious fault than mere negligence. . . ." Clegg v. Conk, 507 F.2d 1351, 1361, 1362 (1972) certiorari denied, 422 U.S. 1007 (1975). And, the Fifth Circuit likewise held in Vohs v. Dickson, 495 F.2d 607, 622 (1974), that "some culpability beyond mere negligence is required for liability under 10b-5."

The Fourth Circuit, in Carras v. Burns, 516 F.2d 251, 256 (1975) had noted both that the courts have agreed "that §10(b) and Rule 10b-5 have eliminated the need to prove common law intent to defraud" and further that "[i]t is sufficient if the defendant 'knew the statement

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5/ Parrent v. Midwest Rug Mills, Inc., 455 F.2d 123 (1972), an earlier decision of the Seventh Circuit which is discussed in the Tomera case, arrived at the same conclusion in the context of determining the correct statute of limitations period for Rule 10b-5 claims. See also, Kohler v. Kohler Co., 319 F.2d 634 (C.A. 7, 1963).

6/ See also, Myzel v. Fields, 386 F.2d 718, 735-736 (C.A. 8, 1967), certiorari denied, 390 U.S. 951 (1968), where the court stated that proof of scienter was not required under Section 10(b) and Rule 10b-5.

7/ Earlier, in Shemtob v. Shearson Hammill & Co., Inc., 448 F.2d 442 (C.A. 2, 1971), the Second Circuit had remarked that no violation of Rule 10b-5 occurs "in the absence of allegation of facts amounting to scienter, intent to defraud, reckless disregard for the truth, or knowing use of a device, scheme, or artifice to defraud. It is insufficient to allege mere negligence." Id. at 445 (emphasis in original).

was misleading or knew of the existence of facts which, if disclosed, would have shown it to be misleading,'" citing Globus v. Law Research Service, Inc., 418 F.2d 1276, 1290 (C.A. 2, 1969). But the court in Carras, then proceeded to rely on the White decision and stated that the defendant-broker's liability would depend upon the nature of his relationship with the plaintiffs.

B. The facts in the Hochfelder case

Leston B. Nay was president and owner of 92 percent of the stock of First Securities Company of Chicago, a small brokerage firm. Nay induced Mrs. Hochfelder and other customers of the brokerage firm to invest in so called "escrow accounts" that he represented would yield a high rate of return. These persons did so from 1942 through 1966. In fact, there were no such escrow accounts; Nay converted the funds to his own use immediately upon receipt. The customers had made their payments directly to Nay. No escrow accounts were reflected on the books and records of the brokerage firm, nor were they shown on the firm's periodic accountings to its customers.

The fraud came to light in 1968, when Nay committed suicide; in his suicide note he described the brokerage firm as bankrupt and the escrow accounts as "spurious." Immediately thereafter the Commission commenced proceedings which resulted in the appointment of a receiver for First Securities. The claims based on the escrow accounts were ultimately allowed against the brokerage firm, 8/ but there were not sufficient assets to satisfy these claims in full. The escrow claimants, in 1971, filed an action seeking damages against the Midwest Stock Exchange, of which First Securities had been a member, and Ernst & Ernst, an accounting firm. Summary judgment in favor of the Exchange was affirmed on appeal. 9/

Ernst & Ernst had been retained from 1946 through 1967 by First Securities to perform annual audits of First Securities' books and records. In connection with these audits, Ernst & Ernst prepared for First Securities Forms X-17A-5, 10/ which were required to be filed

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8/ Securities and Exchange Commission v. First Securities Co., 463 F.2d 981, 986 (C.A. 7), certiorari denied, 409 U.S. 880 (1972).

9/ Hochfelder v. Midwest Stock Exchange, 503 F.2d 364 (C.A. 7) certiorari denied, 419 U.S. 875 (1974).

10/ Form X-17A-5 is the form the Commission has prescribed for annual reports of brokers' financial condition.

by First Securities with the Commission pursuant to Securities Exchange Act Rule 17a-5. 11/

With respect to Ernst & Ernst, the complaint alleged that the accounting firm aided and abetted the fraud which Nay had perpetrated upon the plaintiffs as customers of First Securities in violation of Section 10(b) and Rule 10b-5. In essence, the theory of the complaint was that Ernst & Ernst failed to exercise proper and appropriate auditing procedures in its audits of First Securities and that this failure resulted in Ernst & Ernst's failure to discover certain practices of First Securities, 12/ the discovery of which would have led to the discovery of Nay's fraudulent activities. The plaintiffs contended that had Ernst & Ernst conducted a proper audit of First Securities it would have discovered certain of the practices which permitted Nay to conceal his fraudulent activities. Discovery of such practices would have had to have been reflected in the Forms X-17A-5 filed by First Securities and such disclosure would have led to an investigation of First Securities by various regulatory authorities. The plaintiffs contended that such an investigation, in turn, would have led to discovery of Nay's fraudulent activities.

11/ Rule 17a-5 required, among other things, that the Forms X-17A-5 include a certificate which stated "clearly the opinion of the accountant with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein." The rule also required Ernst & Ernst to state in its certificate "whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances." In addition, the rule provided that nothing in it should "be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions" required by the rule.

In 1975 Section 17(a) of the Securities Exchange Act was amended in certain respects not relevant to determination of the issues presented in the *Hochfelder* case. See Section 14 of the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 137 (June 4, 1975). In addition, Securities Exchange Act Rule 17a-5 was amended in 1975 in certain limited respects. See 17 CFR 240.17a-5 (1976).

12/ These practices included the fact that Nay took no regular vacations and the existence of a "mail rule" which required that all mail addressed to Nay at First Securities, or mail addressed to First Securities to the attention of Nay, could not be opened by anyone other than Nay. In addition, if Nay absented himself from the firm for several days, all mail addressed to him was to be left unopened on his desk. It was argued that Nay was able to cover up his fraudulent activities by reason of this "mail rule."

It is important to note that Ernst & Ernst had no knowledge of Nay's activities. Indeed, the issue throughout the entire litigation was whether Ernst & Ernst was liable for having failed to discover the fraud.

C. The district court's decision

After extensive discovery by the parties to the action, the district court granted Ernst & Ernst's motion for summary judgment and ordered that the action be dismissed. The district court held that there was no evidence that Ernst & Ernst had been negligent in auditing First Securities or in failing to discover Nay's mail rule. In addition, it held that no genuine issue of material fact existed as to whether Ernst & Ernst had conducted its audit of First Securities in accordance with generally accepted auditing standards. The plaintiffs then appealed from the district court's judgment and order.

D. The Court of Appeals' decision

The Court of Appeals for the Seventh Circuit reversed and remanded, holding that

> "where, as here, it is urged that the defendant through action as well as inaction has facilitated the fraud of another, a claim for aiding and abetting is made on demonstrating: (1) that the defendant had a duty of inquiry; (2) the plaintiff was a beneficiary of that duty of inquiry; (3) the defendant breached the duty of inquiry; (4) concomitant with the breach of duty of inquiry the defendant breached a duty of disclosure; and (5) there is a causal connection between the breach of duty of inquiry and disclosure and the facilitation of the underlying fraud; that is, adequate inquiry and subsequent disclosure would have led to the discovery of the underlying fraud or its prevention."

Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1104 (C.A. 7, 1974)

The court of appeals reasoned that there were questions of fact concerning whether Ernst & Ernst's failure to discover and comment upon Nay's mail rule constituted a breach of its duty as an auditor to investigate First Securities' system of internal accounting control (id. at 1111); and whether "adequate inquiry and subsequent disclosure on Ernst & Ernst's part would have led to the discovery or prevention of Nay's fraud" (id. at 1115).

E. The Commission's amicus curiae brief

The Commission had not participated in the litigation in the lower courts, nor had it taken any action against Ernst & Ernst. When the Supreme Court granted the petition of Ernst & Ernst to review the decision of the court of appeals, it requested the Commission to give its views.

The Commission filed an amicus curiae brief 13/ and participated in oral argument.

The Commission argued that Section 10(b) is not limited to the prohibition of intentional misconduct, but that the section proscribes negligent as well as intentional misconduct inasmuch as victims of manipulative and deceptive securities practices may be equally injured by both types of conduct. Similarly, the Commission stated that it viewed Rule 10b-5 as a broad prohibition against both intentional and negligent conduct which may be injurious to innocent investors. Yet, although the Commission argued that negligent conduct may be sufficient to establish a violation of Section 10(b) and Rule 10b-5, it also asserted that not every negligent violation of the statute and the rule would entitle a private plaintiff to recovery of civil money damages. Instead, based upon its analysis of certain other provisions in the Securities Act of 1933 and the Securities Exchange Act of 1934, which expressly provide civil remedies for statutory violations, the Commission argued that a plaintiff should be entitled to recover money damages for negligent violation of Rule 10b-5 where the circumstances indicate "(i) the defendant knew or reasonably could forsee that the plaintiff would rely on his conduct, (ii) the plaintiff did in fact so rely, and (iii) the amount of the plaintiff's damages caused by the defendant's conduct was definite and ascertainable" (96 S. Ct. at 1383, n. 18). Where, on the other hand, the defendant's conduct was reckless, willful or intentional instead of merely negligent, a violation of Rule 10b-5 would be a sufficient basis for liability on a showing that such violation had injured the plaintiff, without more.

These views were a distillation of an analysis made in the Commission's brief of the express liability provisions in the 1933 and 1934 Acts, and reflected, it was believed, a harmonizing of the scope of damages liability in actions brought under Section 10(b) and Rule 10b-5

13/ In its brief, a copy of which is attached to this memorandum, disagreeing with the holding of the Court of Appeals, the Commission expressed the view that because of a lack of a sufficient nexus between the injured escrow claimants and Ernst & Ernst, it was not established that the accounting firm should be liable to them in damages, even if the firm had been negligent. The Commission noted that the escrow claimants had not relied, directly or indirectly, on Ernst & Ernst's audits; the financial statements prepared by Ernst & Ernst could not have been reasonably forseen or likely to induce the escrow claimants to invest in Nay's escrow accounts and Ernst & Ernst could not reasonably have anticipated any damages to this class of persons. As summarized in the text on this page, the Commission did spell out circumstances, although not presented in this case, where civil damage liability could result from a negligent violation of Section 10(b) and Rule 10b-5.

(which do not expressly provide for damages for their violation) with the varying standards of fault contained in the securities laws' provisions giving express civil remedies. In this way, the Commission sought to glean the guidance Congress had furnished in the express remedies in fashioning the appropriate contours of the implied action under Rule 10b-5.

F. The decision of the Supreme Court

In its decision, the Supreme Court (6 to 2) rejected the Commission's argument that there should be some circumstances under which civil damage liability may be imposed under Rule 10b-5 for negligent conduct which injures investors. The Court, in seeking the "[a]scertainment of congressional intent" (96 S. Ct. at 1384) with respect to the standard of liability created by Section 10(b), utilized what might be called a "plain meaning of the statute" approach. In its view, the language of Section 10(b) - the words "manipulative or deceptive devices or contrivances" — so clearly connoted intentional misconduct that further inquiry into legislative history was probably not necessary. 14/

The Supreme Court held, as already noted, that a "private cause of action for damages will [not] lie under §10(b) and Rule 10b-5 in the absence of an allegation of 'scienter' — intent to deceive, manipulate, or defraud" (id. at 1381). It should be noted, however, that the Court, recognizing that "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act," chose not to address the issue of "whether, in some circumstances, reckless behavior is sufficient for civil liability under §10(b) and Rule 10b-5" (ibid., n. 12). In addition, the Court also determined not to consider "the question whether scienter is a necessary element in an action for injunctive relief under §10(b) and Rule 10b-5" (id.). 15/

G. Appellate Decisions Since Hochfelder

The extent to which the Hochfelder decision's limiting effect will come to bear upon future private securities litigation presently remains unresolved and as a consequence, we hesitate to speculate in the realm of legal issues which will ultimately be presented to the federal courts for resolution. There are several federal appellate court cases which may be affected by the Hochfelder decision.

14/ The Court turned "nevertheless" (id. at 1385) to selected portions of the legislative history of the Securities Exchange Act and the administrative history of Rule 10b-5.

15/ Similarly, in an earlier footnote the Court remarked that it "need not consider whether civil liability for aiding and abetting is appropriate under [Section 10(b)] and [Rule 10b-5], nor the elements necessary to establish such a cause of action." (96 S. Ct. at 1380, n. 7).

Shortly after its decision in Hochfelder, the Supreme Court granted a petition for a writ of certiorari, vacated the judgment of the Court of Appeals for the Seventh Circuit in Sanders v. Nuveen, 524 F. 2d 1064 (1975), and remanded to that court "for further consideration in light of" the Hochfelder decision. ___ U.S. ___ (April 19, 1976). In Sanders v. Nuveen, the court of appeals had affirmed a finding of damage liability under Rule 10b-5 against an underwriter of short term commercial paper, who acted in the "mistaken but honest belief" that certain financial statements correctly represented the financial condition of the issuer of that paper, and who had breached a duty to make reasonable inquiries which would have led to the discovery of the issuer's, and the accountant's, fraud. 524 F. 2d at 1066. The Commission intends to file an amicus curiae brief in the remanded case.

In Herzfeld v. Laventhol, Krekstein, Horwath and Horwath, CCH Fed. Sec. L. Rep. ¶95,660 (C.A. 2, July 15, 1976), the Court of Appeals for the Second Circuit recently affirmed a district court judgment which held that the defendant accounting firm violated Section 10(b) and Rule 10b-5 in connection with its issuance of a report and preparation of audited financial statements. Based upon the evidence adduced at trial, the district judge, concluding that the audited financial statements were misleading and that the accounting firm discovered in the course of its work certain facts which were omitted from its report and notes to the audited financial statements and which facts should have been revealed to investors, stated that "[t]he evidence . . . clearly demonstrates that [the firm] had actual knowledge of the omitted facts which render[ed] its report misleading." (378 F. Supp. 112, 127 (S.D. N.Y. 1974)). In affirming the judgment of the district court, the Second Circuit, cognizant of the Supreme Court's Hochfelder decision, remarked that there was no question that the amended complaint adequately alleged scienter on the part of the accounting firm. In its discussion of Hochfelder, the Court of Appeals noted that the plaintiffs had proceeded on a theory of negligence against Ernst & Ernst whereas Herzfeld involved "affirmative acts by [the accounting firm] which were materially misleading" and continued:

> "The accountants here are not being cast in damages for negligent nonfeasance or misfeasance, but because of their active participation in the preparation and issuance of false and misleading accounting reports upon which [the plaintiff] relied to his damage."

Id. at p. 90,261.

This distinction between knowing action and negligence also was drawn by the Court of Appeals for the Ninth Circuit in an order entered last month denying rehearing in United States v. Charnay, No. 75-1222 (C.A. 9, July 8, 1976). There, in a case which sustained a criminal indictment for violations of Section 10(b) and Rule 10b-5, the court

of appeals stated that in its opinion on the merits it had noted that, consistent with Hochfelder, it was necessary for the prosecution to show only an intentional act with "a realization on the defendant's part that he was doing a wrongful act." Slip op. at 3. Similarly, the court observed that one of the panel judges in his concurring opinion had noted that "the intent necessary . . . is merely that of intending to do the acts prohibited, rather than intent to violate the statute." Ibid.

Accord, Bailey v. Meister Brau, Inc., CCH Fed. Sec. L. Rep. ¶95,543 (C.A. 7, May 6, 1976).

II. Other, more limited remedies, may be available under the federal securities laws in private actions against accountants

Since Section 10(b) and Rule 10b-5, in light of Hochfelder, may no longer continue to remain the most litigated provisions of the federal securities laws, 16/ we believe that it is important the Subcommittee should not lose sight of the fact that defrauded investors in certain circumstances will continue to have available other provisions of the federal securities laws upon which private actions for civil damages may be grounded and where scienter is not an element necessary for recovery. For example, Section 11(a) of the Securities Act of 1933 provides, inter alia, that in connection with a public distribution of securities pursuant to a false or misleading registration statement persons who signed such registration statement and experts, including accountants, whose certificates, reports or opinions are included in the registration statement, may be liable to persons acquiring such securities. Under Section 11(b)(3), however, those persons signing the registration statement, other than the issuer of the securities, are not liable for the false or misleading registration statement if they show that, after making a reasonable investigation, they had reasonable grounds to and did believe that the registration statement was correct. 17/ Similarly, Section 18(a) of the Securities Exchange Act provides that persons who have filed false and misleading statements with the Commission "shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have

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16/ See, e.g., Securities and Exchange Commission v. National Securities Inc., 393 U.S. 453, 465 (1969).

17/ The Supreme Court in Hochfelder (96 S. Ct. at 1388) noted that experts such as accountants are accorded a "due diligence" defense under Section 11(b)(3)(i), and stated that "[i]n effect, this is a negligence standard."

purchased or sold a security at a price which was affected by such statement" unless the person who filed the statement proves that the statement was made "in good faith" and without "knowledge that such statement was false or misleading." Perhaps accountants, whose financial reports are included in such filings, could be held liable as aiding and abetting a violation of this section.

In addition to the statutory provisions noted above which provide for express private rights of action, it appears that Section 17(a) of the Securities Act of 1933, to the extent that an implied private right of action exists under that provision, may permit purchasers to sue accountants and other persons for fraud without pleading or proving scienter. 18/ In general, Section 17(a) makes it unlawful for any person, in the offer or sale of securities, by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, to employ any device, scheme or artifice to defraud, or to obtain money or property by means of false or misleading statements, or to engage in any transaction or course of business which operates or would operate as a fraud or deceit upon the purchaser. Significantly, Section 17(a) is not limited to "manipulative or deceptive devices or contrivances," which language appears in Section 10(b) of the Securities Exchange Act, and the interpretation of which language served in large part as the basis in Hochfelder for the holding that only conduct involving scienter is proscribed by Section 10(b). 19/ Yet, the proscriptions of Section 17(a) extend only to the specified activities by persons engaged in the offer or sale of any securities, whereas Section 10(b) proscribes certain activities in connection with the purchase or sale of any securities; that is, Section 17(a) reaches only defrauded purchasers of securities

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18/ In Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 733-734, n. 6 (1975), the Supreme Court declined to express an opinion on whether Section 17(a) gives rise to an implied cause of action. Various lower federal courts, however, have split on the resolution of this issue. Following the decision in Hochfelder, the Supreme Court denied a petition for a writ of certiorari which raised that question, among others, Schaefer v. First National Bank of Lincolnwood, 509 F. 2d 1287 (C.A. 7, 1975), cross petitions for certiorari denied, Docket Nos. 74-1407 and 74-1366 (April 19, 1976).

19/ Former Associate Supreme Court Justice William O. Douglas commented in an article written before he ascended to the high court, that Section 17 "makes unlawful even innocent acts to obtain money or property by means of untrue statements of material facts or ommissions to state material facts." Douglas & Bates, "The Federal Securities Act of 1933," 43 Yale L. J. 171, 181 (1933).

whereas Rule 10b-5 reaches defrauded sellers as well as purchasers. Accordingly, while Section 17(a) may permit an implied private right of action for fraudulent conduct not involving scienter, the potential class of defrauded investors would not encompass those investors who have been defrauded in the sale of their securities. 20/

III. Impact on the Commission's own civil injunctive actions may not be substantial

The precise impact and full implications of Hochfelder remain, of course, ultimately to be determined by the lower federal courts in future securities litigation. It appears initially, however, that this decision will bear significantly upon the future course and development of federal securities litigation under, at least, Section 10(b) and Rule 10b-5. In this connection, the May 19 letter from Senator Metcalf notes that the Hochfelder decision "imperils the success of private damage suits for securities fraud by setting an absurdly lax standard of care for accountants." While we recognize that the interest of the Subcommittee in the Hochfelder decision, in large measure, relates to the Subcommittee's responsibilities in connection with the accounting profession and the promotion of sound accounting practices, it should be noted that the Supreme Court's analysis in Hochfelder of Section 10(b) and Rule 10b-5 may transcend limited application to factual situations involving accountants and, in fact, may be deemed to be equally applicable to other securities litigation commenced under the same statutory provision and rule irrespective of the identity of the defendant.

Whatever impact the Hochfelder decision may have on future securities litigation, we believe any meaningful analysis of that decision, even at this early stage, must distinguish between private actions seeking redress through civil money damages and those actions for injunctive relief against future violations of the federal securities laws which are instituted by the Commission pursuant to statutory authority.

We regard as significant the fact that the Supreme Court in Hochfelder chose to leave open the question of whether scienter is a necessary element in an injunctive action under Section 10(b) and Rule 10b-5. In our opinion, the determination not to resolve this issue served as an implicit recognition by the Court of the basic differences between Commission injunctive actions and private actions seeking

20/ Of course, there are also actions which may be instituted against accountants under state law. See, e.g., Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931)(Cardozo, C.J.), cited in Hochfelder, 96 S. Ct. at 1391, n. 33.

damages for violations of the federal securities laws. Among these differences is the fact that private actions for money damages are retrospective in that such actions serve to compensate investors who have suffered from past violations of the federal securities laws whereas Commission enforcement actions may be regarded as prospective in the sense that Commission seeks to protect the public interest and the interests of investors by enjoining future violations of the federal securities laws. In its amicus curiae brief in the Supreme Court, the Commission argued that there was a difference between the question of whether a violation had occurred and the question of whether, as a result of the violation, the plaintiff was entitled to a remedy for that violation -- damages or some other relief. 21/ When the defendant's conduct was merely negligent, the Commission argued a violation of Rule 10b-5 could result, even though the question of whether the court should impose monetary liability in a private action should depend upon the factors we have already discussed -- forseeability, reliance and ascertainable damages. On the other hand, an injunction could more easily be imposed for negligent conduct than could monetary damages, because the injunction is a "mild prophylatic" only directing that the defendant do what he is obligated to do at any rate -- obey the law. 22/

Moreover, recovery in private actions is premised upon, inter alia, a showing of a prior violation of law, but the Commission is not similarly required to adduce proof of a prior violation as a prerequisite to obtaining injunctive relief. The statutes under which most of its injunctive actions are brought do not require that a past violation of law be established; rather, they authorize the Commission to seek injunctive relief where the defendant is violating or is about to

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21/ The Supreme Court noted in an earlier case that "the question of liability and relief are separate in private actions under the securities laws, and . . . the latter is to be determined according to traditional principles." Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 65 (1975); see also, Mills v. Electric Auto-Lite Co., 396 U.S. 375, 386 (1970). Similarly, there have been occasions where courts, in injunctive actions brought by the Commission, have found that the defendants had violated the law, but nonetheless declined to issue an injunction.

22/ In leaving open the question of whether scienter is a necessary element in an injunctive action, the Supreme Court referred to its prior decision in Securities and Exchange Commission v. Capital Gains, 375 U.S. 180, where the Court had remarked both that "it is not necessary in a suit for equitable or prophylactic relief to establish all the elements in a suit for damages," (id. at 193) and that the securities laws should be interpreted flexibly, not technically and restrictively, in order to effectuate their remedial purposes of avoiding fraud. Id. at 195.

violate a provision of the statutes or a rule or regulation thereunder. 23/ The court may issue an injunction "upon a proper showing." In fact, the Commission generally has sought to establish prior violations in order to provide a basis upon which a court may draw the inference that a reasonable likelihood exists that, unless enjoined, a defendant will violate again in the future. 24/

The Supreme Court has previously recognized that private damage actions are a "necessary supplement" to the Commission's enforcement activities. See, Mills v. Auto-Lite Co., 396 U.S. 375, 382 (1970); J. I. Case Co. v. Borak, 377 U.S. 426, 432 (1964). In our view, in the past year or two, decisions of the Supreme Court evidence a trend toward some cutting back on this principle as the Court limits access by private parties to the federal courts. At the same time, however, these cases generally view federal agency law enforcement in a different context. For example, in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), the Court upheld the Birnbaum rule which provides that the plaintiff must be a purchaser or seller of securities in order to institute a private action for damages under Section 10(b) and Rule 10b-5. But the Court in Blue Chip also affirmed an earlier opinion holding that the purchaser-seller rule did not impose a limitation on the Commission's standing to institute injunctive actions for violations of that statutory section and the Rule (421 U.S. at 751, n. 14).

Similarly, in Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 57-65 (1975), the Court emphasized that a private plaintiff which brought an action to enjoin violations of Section 13(d) of the Securities Exchange Act was not relieved of the burden of showing irreparable injury and the other traditional prerequisites for obtaining private injunctive relief, such as the inadequacy of legal remedies. Although the Court in Rondeau did not discuss Commission actions brought to enjoin violations of the securities laws, it is clear that the Rondeau decision was directed to "private litigants" and "competing private claims" (id. at 50, 61). Yet, it is well established that the Commission, as the agency authorized by

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23/ See, for example, Section 20 of the Securities Act of 1933, 15 U.S.C. 77t; Section 21 of the Securities Exchange Act of 1934, 15 U.S.C. 78u; and Section 18 of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79r.

24/ Courts have generally applied this "reasonable likelihood" standard in determining whether to issue an injunction in Commission actions. See Securities and Exchange Commission v. Management Dynamics, 515 F.2d 801, (C.A. 2, 1975); Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1100 (C.A. 2, 1970); Securities and Exchange Commission v. Keller Corp., 323 F.2d 397 (C.A. 7, 1963). But see Securities and Exchange Commission v. Coffey, 493 F.2d 1304 (C.A. 6, 1974), certiorari denied, 420 U.S. 908 (1975).

the statutue to institute actions to enjoin violations of the federal securities laws, need not prove all the necessary elements requisite for a private party to obtain injunctive relief. See, e.g., Securities and Exchange Commission v. Management Dynamics, Inc., 515 F.2d 801, 815 (C.A. 2, 1975). 25/

With respect to Commission injunctive actions, the extent of the impact of Hochfelder remains to be determined. Prior to Hochfelder, as you may be aware, a substantial body of law had developed which held both that the Commission need not prove scienter in its actions and also that negligence could serve as a basis sufficient to obtain injunctive relief. 26/ The Hochfelder decision did not reach the holdings in these cases, but it appears that counsel for defendants in Commission actions may well attempt to persuade the courts that the Hochfelder analysis of Section 10(b) and Rule 10b-5, although specifically rendered in the context of a private action for civil damages, is equally applicable to Commission injunctive actions. In this connection, we have attached as Appendix B a copy of a memorandum from the Commission's Office of the General Counsel to all staff attorneys which sets forth that Office's initial observations regarding Hochfelder and which contains certain

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25/ Similarly, Alyeska Pipeline Service Co. v. Wilderness Society, 421 U.S. 240 (1975), and Cort v. Ash, 422 U.S. 66 (1975), two cases not involving the federal securities laws, also evidence the Supreme Court's attitude of restricting access to the federal courts. In the Alyeska Pipeline case the Court severely limited those instances where a district court may award private plaintiffs attorneys' fees, thus appearing to cut back on the "private attorney general" concept of J.I. Case Co. v. Borak, 377 U.S. 426 (1964). And in Cort v. Ash, where the plaintiff sought to allege a private claim for relief under a statute which prohibited illegal corporate campaign contributions, the Court held that it would not imply a private cause of action under such a statute.

26/ See Securities and Exchange Commission v. Management Dynamics, Inc., supra, 515 F.2d 801; Securities and Exchange Commission v. Spectrum, Ltd., 489 F.2d 535 (C.A. 2, 1973); Securities and Exchange Commission v. Texas Gulf Sulphur Co., 401 F.2d 833 (C.A. 2, 1968) (Judge Friendly concurring). To the extent that Securities and Exchange Commission v. Coffey, 493 F.2d 1304, 1314 (C.A. 6, 1974) certiorari denied, 420 U.S. 908 (1975) requires the Commission to show "willful and reckless disregard for the truth" in order to obtain an injunction under Section 10(b) and Rule 10b-5, we believe that decision was erroneously decided.

suggestions for dealing with problems which may arise as a result of defense counsels' reliance on Hochfelder. 27/

IV. Proceedings involving accountants under Rule 2(e) of the Commission's Rules of Practice

Pursuant to Senator Metcalf's letter of April 26, 1976, requesting certain information concerning proceedings involving accountants initiated pursuant to Rule 2(e), 17 CFR 201.2(e), we prepared a memorandum answering a number of questions. We noted in that memorandum (p. 3, n. 2) that the Hochfelder decision may have, as one of its results, a greater reliance by the Commission upon Rule 2(e) as a means of preventing a recurrence of unethical or improper conduct by professionals, such as accountants and attorneys.

Rule 2(e) provides that the Commission may permanently or temporarily deny the privilege of appearing or practicing before it to any person who is found, after notice and an opportunity for hearing:

> "(i) not to possess the requisite qualifications to represent others;
>
> "(ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or

. . . .

27/ In connection with the issue of whether scienter is a necessary element in Commission actions for injunctive relief, we regard the recent statement of the Senate Committee on Banking, Housing and Urban Affairs as particularly instructive and as providing an indication of the probable determination of the issue when presented for resolution in the federal courts.

> "Private actions frequently will involve more parties and more issues than the Commission's enforcement action, thus greatly increasing the need for extensive pre-trial discovery. In particular, issues related to matters of damages, such as scienter, causation, and the extent of damages, are elements not required to be demonstrated in a Commission injunctive action." (citation omitted)(emphasis is original).

Senate Report No. 94-75, 94th Cong., 2d Sess. p. 76 (1975). This statement was made in the context of the Committee's discussion of proposed subsection (g) of Section 21 of the Securities Exchange Act which would exempt Commission actions from consolidation with other actions not brought by the Commission, unless the Commission consents. This subsection was enacted as part of the Securities Acts Amendments of 1975, Pub. Law 94-79, 89 Stat. 97, et. seq. (June 4, 1976).

(iii) to have willfully violated, or willfully aided and abetted the violation of, any provision of the Federal securities laws . . . or the rules and regulations promulgated by the Commission thereunder."

"Practice" before the Commission is defined by Rule 2(g) of the Commission's Rules of Practice to include, but is not limited to, "(1) transacting any business with the Commission; and (2) the preparation of any statement, opinion or other paper by an attorney, accountant. . . or other expert . . ." that is filed with the Commission with his or her consent.

There may be cases where, as a consequence of Hochfelder, negligent conduct by an accountant or attorney which injured investors may not constitute a violation of Section 10(b) and Rule 10b-5, nor otherwise violate the securities laws, yet represent a substantial threat to the public interest if such conduct were to continue in the future. If this conduct would amount to a significant deviation from professional standards, a proceeding under Rule 2(e) to test the individual's fitness to continue to be permitted to practice before the Commission might be appropriate.

HLPitt ---- 51108
PGonson --- 51178
JMMahoney - 51297

TSonde ---- 55724
RSharp ---- 54876

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

ERNST & ERNST *v.* HOCHFELDER ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 74-1042. Argued December 3, 1975—Decided March 30, 1976

Petitioner accounting firm was retained to audit periodically a brokerage firm's books and records. Respondents, who were customers of the brokerage firm, invested in a securities scheme ultimately revealed as fraudulent and perpetrated by the firm's president and principal stockholder. After the fraud came to light, respondents filed an action for damages against petitioner under § 10 (b) of the Securities Exchange Act of 1934 (1934 Act), which makes it unlawful to use or employ "any manipulative or deceptive device or contrivance" in contravention of Securities and Exchange Commission (SEC) rules. It was alleged that the brokerage firm president's scheme violated § 10 (b) and SEC Rule 10b-5, and that petitioner had "aided and abetted" the violations by its "failure" to conduct proper audits of the firm, thereby failing to discover internal practices that prevented an effective audit. The District Court granted petitioner's motion for summary judgment and dismissed the action, holding that whether or not a cause of action could be based merely on allegations of negligence, there was no genuine issue of material fact as to whether petitioner had conducted its audits in accordance with generally accepted standards. The Court of Appeals reversed and remanded, holding that one who breaches a duty of inquiry and disclosure owed another is liable in damages for aiding and abetting a third party's violation of Rule 10b-5 if the fraud would have been discovered or prevented but for the breach, and that there were genuine issues of fact as to whether petitioner committed such a breach and whether inquiry and disclosure would have led to discovery or prevention of the president's fraud. *Held:*

1. A private cause of action for damages will not lie under

§ 10 (b) and Rule 10b–5 in the absence of any allegation of "scienter," *i. e.*, intent to deceive, manipulate, or defraud on the defendant's part. Pp. 8–27.

(a) The use of the words "manipulative," "device," and "contrivance" in § 10 (b) clearly shows that it was intended to proscribe a type of conduct quite different from negligence, and more particularly the use of the word "manipulative," virtually a term of art used in connection with securities markets, connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities. Pp. 11–14.

(b) The 1934 Act's legislative history also indicates that § 10 (b) was addressed to practices involving some element of scienter and cannot be read to impose liability for negligent conduct alone. Pp. 14–19.

(c) The structure of the 1934 Act and the interrelated Securities Act of 1933 (1933 Act) does not support the contention that since § 10 (b), in contrast to certain other sections of these Acts, is not by its terms explicitly restricted to willful, knowing, or purposeful conduct, it should not be construed to require more than negligent action or inaction as a precondition for civil liability. In each instance that Congress in these Acts created express civil liability in favor of purchasers or sellers of securities it clearly specified whether recovery was to be premised on knowing or intentional conduct, negligence, or entirely innocent mistake. The express recognition of a cause of action premised on negligent behavior in § 11, for example, stands in sharp contrast to the language of § 10 (b). Moreover, each of the express civil remedies in the 1933 Act allowing recovery for negligent conduct is subject to significant procedural restrictions indicating that the judicially created private damage remedy under § 10 (b)—which has no comparable restrictions—cannot be extended, consistently with Congress' intent, to actions premised on negligence, since to do so would allow causes of action under these express 1933 Act remedies to be brought instead under § 10 (b), thereby nullifying the effectiveness of such restrictions on those remedies. Pp. 20–24.

(d) While there is language in Rule 10b–5 that could arguably be read as proscribing any type of material misstatement or omission and any course of conduct that has the effect of defrauding investors, whether the wrongdoing was intentional or not, such a reading does not comport with the Rule's administrative history which makes it clear that it was intended to apply only to

Syllabus

activities involving scienter. More importantly, the scope of Rule 10b–5 cannot exceed the power granted the SEC under § 10 (b), whose language and history compel interpreting the Rule to apply only to intentional wrongdoing. Pp. 25–27.

2. The case will not be remanded for further proceedings to require proof of more than negligent misfeasance by petitioner, since throughout the history of the case respondents have proceeded on a theory of liability premised on negligence, in fact specifically disclaiming that petitioner had engaged in fraud or intentional misconduct. P. 28.

503 F. 2d 1100, reversed.

Powell, J., delivered the opinion of the Court, in which Burger, C. J., and Stewart, White, Marshall, and Rehnquist, JJ., joined. Blackmun, J., filed a dissenting opinion, in which Brennan, J., joined. Stevens, J., took no part in the consideration or decision of the case.

SUPREME COURT OF THE UNITED STATES

No. 74–1042

Ernst & Ernst, Petitioner, *v.* Olga Hochfelder et al.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[March 30, 1976]

MR. JUSTICE POWELL delivered the opinion of the Court.

The issue in this case is whether an action for civil damages may lie under § 10 (b) of the Securities Exchange Act of 1934 (1934 Act), 48 Stat. 891, 15 U. S. C. § 78j (b), and Securities and Exchange Commission Rule 10b–5, 17 CFR § 240.10b–5, in the absence of an allegation of intent to deceive, manipulate, or defraud on the part of the defendant.

I

Petitioner, Ernst & Ernst, is an accounting firm. From 1946 through 1967 it was retained by First Securities Company of Chicago (First Securities), a small brokerage firm and member of the Midwest Stock Exchange and of the National Association of Securities Dealers, to perform periodic audits of the firm's books and records. In connection with these audits Ernst & Ernst prepared for filing with the Securities and Exchange Commission (the Commission) the annual reports required of First Securities under § 17 (a) of the 1934 Act, 15 U. S. C. § 78q (a).[1] It also prepared for First Securities responses

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[1] Section 17 (a) requires that securities brokers or dealers "make . . . and preserve . . . such accounts . . . books, and other

to the financial questionnaires of the Midwest Stock Exchange (the Exchange).

Respondents were customers of First Securities who invested in a fraudulent securities scheme perpetrated by Leston B. Nay, president of the firm and owner of 92% of its stock. Nay induced the respondents to invest funds in "escrow" accounts that he represented would yield a high rate of return. Respondents did so from 1942 through 1966, with the majority of the transactions occurring in the 1950's. In fact, there were no escrow accounts as Nay converted respondents' funds to his own use immediately upon receipt. These transactions were not in the customary form of dealings between First Securities and its customers. The respondents drew their personal checks payable to Nay or a designated bank for his account. No such escrow accounts were reflected on the books and records of First Securities, and none was shown on its periodic accounting to respondents in connection with their other investments. Nor were they included in First Securities' filings with the Commission or the Exchange.

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records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors." During the period relevant here, Commission Rule 17a-5, 17 CFR § 240.17a-5, required that First Securities file an annual report of its financial condition that included a certificate stating "clearly the opinion of the accountant with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein." See SEC Release No. 3338 (Nov. 28, 1948), X-17A-5 (h). The rule required Ernst & Ernst to state in its certificate, *inter alia*, "whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances" and provided that nothing in the rule should "be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit for the purpose of expressing the opinions required" by the rule.

This fraud came to light in 1968 when Nay committed suicide, leaving a note that described First Securities as bankrupt and the escrow accounts as "spurious." Respondents subsequently filed this action [2] for damages against Ernst & Ernst [3] in the United States District Court for the Northern District of Illinois under § 10 (b) of the 1934 Act. The complaint charged that Nay's escrow scheme violated § 10 (b) and Commission Rule 10b-5,[4] and that Ernst & Ernst had "aided and abetted" Nay's violations by its "failure" to conduct proper audits of First Securities. As revealed through discovery, respondents' cause of action rested on a theory of negligent nonfeasance. The premise was that Ernst & Ernst had failed to utilize "appropriate auditing procedures" in its audits of First Securities, thereby failing to discover internal practices of the firm said to prevent an effective audit. The practice principally relied on was Nay's rule that only he could open

[2] Two separate, but substantially identical, complaints initially were filed by different members of the present group of respondents. Subsequently the respondents jointly filed a First Amended Complaint. The two cases were treated by the District Court as if they were consolidated and were consolidated formally on appeal.

[3] The first count of the complaint was directed against the Exchange, charging that through its acts and omissions it had aided and abetted Nay's fraud. Summary judgment in favor of the Exchange was affirmed on appeal. *Hochfelder* v. *Midwest Stock Exchange*, 503 F. 2d 364 (CA7), cert. denied, 419 U. S. 875 (1974).

[4] Immediately after Nay's suicide the Commission commenced receivership proceedings against First Securities. In those proceedings all of the respondents except two asserted claims based on the fraudulent escrow accounts. These claims ultimately were allowed in *SEC* v. *First Securities Co.*, 463 F. 2d 981, 986 (CA7 1972), cert. denied, 409 U. S. 880 (1973), where the court held that Nay's conduct violated § 10 (b) and Rule 10b-5, and that First Securities was liable for Nay's fraud as an aider and abettor. The question of Ernst & Ernst's liability was not considered in that case.

mail addressed to him at First Securities or addressed to First Securities to his attention, even if it arrived in his absence. Respondents contended that if Ernst & Ernst had conducted a proper audit, it would have discovered this "mail rule." The existence of the rule then would have been disclosed in reports to the Exchange and to the Commission by Ernst & Ernst as an irregular procedure that prevented an effective audit. This would have led to an investigation of Nay that would have revealed the fraudulent scheme. Respondents specifically disclaimed the existence of fraud or intentional misconduct on the part of Ernst & Ernst.[5]

After extensive discovery the District Court granted Ernst & Ernst's motion for summary judgment and dismissed the action. The court rejected Ernst & Ernst's contention that a cause of action for aiding and abetting a securities fraud could not be maintained under § 10 (b) and Rule 10b–5 merely on allegations of negligence. It concluded, however, that there was no genuine issue of material fact with respect to whether Ernst & Ernst had conducted its audits in accordance with generally accepted auditing standards.[6]

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[5] In their response to interrogatories in the District Court respondents conceded that they did "not accuse Ernst & Ernst of deliberate, intentional fraud," merely with "inexcusable negligence." App. 81.

[6] The District Court also held respondent's action was barred by the doctrine of equitable estoppel and the applicable Illinois statute of limitations of three years. See n. 29, *infra*. As customers of First Securities respondents were sent confirmation forms as required under § 17 (a) and Rule 17a–5 requesting that they verify the accuracy of the statements and notify Ernst & Ernst as to any exceptions. Although the confirmation forms contained no reference to the escrow accounts, Ernst & Ernst was not notified of this fact. The last audit of First Securities by Ernst & Ernst was completed in December 1967 and the first complaint in this action was not filed until February 1971.

The Court of Appeals for the Seventh Circuit reversed and remanded, holding that one who breaches a duty of inquiry and disclosure owed another is liable in damages for aiding and abetting a third party's violation of Rule 10b–5 if the fraud would have been discovered or prevented but for the breach. 503 F. 2d 1100 (1974).[7] The court reasoned that Ernst & Ernst had a common-law and statutory duty of inquiry into the adequacy of First Securities' internal control system because it had contracted to audit First Securities and to prepare for filing with the Commission the annual report of its financial condition required under § 17 of the 1934 Act and Rule 17a–5, 17 CFR § 240.17a–5.[8] The Court further rea-

[7] In support of this holding, the Court of Appeals cited its decision in *Hochfelder* v. *Midwest Stock Exchange, supra,* where it detailed the elements necessary to establish a claim under Rule 10b–5 based on a defendant's aiding and abetting a securities fraud solely by inaction. See n. 3 *supra.* In such a case the plaintiff must show "that the party charged with aiding and abetting had knowledge of or, but for the breach of a duty of inquiry, should have had knowledge of the fraud, and that possessing such knowledge the party failed to act due to an improper motive or breach of a duty of disclosure." *Id.,* at 374. The court explained in the instant case that these "elements constitute a flexible standard of liability which should be amplified according to the peculiarities of each case." 503 F. 2d, at 1104. In view of our holding that an intent to deceive, manipulate, or defraud is required for civil liability under § 10 (b) and Rule 10b–5, we need not consider whether civil liability for aiding and abetting is appropriate under the section and the rule, nor the elements necessary to establish such a cause of action. See, *e. g., Brennan* v. *Midwestern United Life Ins. Co.,* 259 F. Supp. 673 (1966), 286 F. Supp. 702 (ND Ind. 1968), aff'd, 417 F. 2d 147 (CA7 1969), cert. denied, 397 U. S. 989 (1970) (defendant held liable for giving active and knowing assistance to a third party engaged in violations of the securities laws). See generally Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution, 120 U. Pa. L. Rev. 597, 620–645 (1972).

[8] See n. 1, *supra.*

soned that respondents were beneficiaries of the statutory duty to inquire [9] and the related duty to disclose any material irregularities that were discovered. *Id.*, at 1105–1111. The court concluded that there were genuine issues of fact as to whether Ernst & Ernst's failure to discover and comment upon Nay's mail rule [10] constituted a breach of its duties of inquiry and disclosure, *id.*, at 1111, and whether inquiry and disclosure would have led to the discovery or prevention of Nay's fraud. *Id.*, at 1115.[11]

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[9] The court concluded that the duty of inquiry imposed on Ernst & Ernst under § 17 (a) was "grounded on a concern for the protection of investors such as [respondents]," without reaching the question whether the statute imposed a "direct duty" to the respondents. 503 F. 2d, at 1105. The court held that Ernst & Ernst owed no common-law duty of inquiry to respondents arising from its contract with First Securities since Ernst & Ernst did not specifically foresee that respondents' limited class might suffer from a negligent audit, compare *Glanzer* v. *Shepard,* 233 N. Y. 236, 135 N. E. 275 (1922), with *Ultramares Corp.* v. *Touche,* 255 N. Y. 170, 174 N. E. 441 (1931); see, *e. g., R. I. Hospital Trust Nat'l Bank* v. *Swartz,* 455 F. 2d 847, 851 (CA4 1972). Moreover, respondents conceded that they did not rely on the financial statements and reports prepared by Ernst & Ernst or on its certificate of opinion. 503 F. 2d, at 1107.

[10] In their briefs respondents allude to several other alleged failings by Ernst & Ernst in its audit of First Securities, principally its failure to inquire into the collectibility of certain loans by First Securities to Nay and and its failure to follow up on a 1965 memorandum that characterized First Securities' overall system of internal control as weak because of the centralization of functions in the cashier. The Court of Appeals mentioned none of these alleged deficiencies in its opinion in this case, although it did discuss the loans to Nay and certain other related matters in its opinion in *Hochfelder* v. *Midwest Stock Exchange, supra,* at 370–371, holding that the existence of these facts was insufficient to put the Exchange on notice that further inquiry into First Securities' financial affairs was required.

[11] The Court of Appeals also reversed the District Court's holding

We granted certiorari to resolve the question whether a private cause of action for damages will lie under § 10 (b) and Rule 10b-5 in the absence of any allegation of "scienter"—intent to deceive, manipulate, or defraud.[12] 421 U. S. 909 (1975). We conclude that it will not and therefore we reverse.[13]

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with respect to equitable estoppel and the statute of limitations. See n. 6, *supra*. In view of our disposition of the case we need not address these issues.

[12] Although the verbal formulations of the standard to be applied have varied, several courts of appeals have held in substance that negligence alone is sufficient for civil liability under § 10 (b) and Rule 10b-5. See, *e. g., White* v. *Abrams,* 495 F. 2d 724, 730 (CA9 1974) ("flexible duty" standard); *Myzel* v. *Fields,* 386 F. 2d 718, 735 (CA8 1967), cert. denied, 390 U. S. 951 (1968) (negligence sufficient); *Kohler* v. *Kohler Co.,* 319 F. 2d 634 (CA7 1963) (knowledge not required). Other courts of appeals have held that some type of scienter—*i. e.,* intent to defraud, reckless disregard for the truth, or knowing use of some practice to defraud—is necessary in such an action. See, *e. g., Clegg* v. *Conk,* 507 F. 2d 1351, 1361-1362 (CA10 1974), cert. denied, 422 U. S. 1007 (1975) (an element of "scienter or conscious fault"); *Lanza* v. *Drexel & Co.,* 479 F. 2d 1277, 1306 (CA2 1973) ("willful or reckless disregard" of the truth). But few of the decisions announcing that some form of negligence suffices for civil liability under § 10 (b) and Rule 10b-5 actually have involved only negligent conduct. *Smallwood* v. *Pearl Brewing Co.,* 489 F. 2d 579, 606 (CA5), cert. denied, 419 U. S. 879 (1974); *Kohn* v. *American Metal Climax, Inc.,* 458 F. 2d 255, 286 (CA3 1972) (Adams, J., concurring); Bucklo, Scienter and Rule 10b-5, 67 Nw. U. L. Rev. 562, 568-570 (1972).

In this opinion the term "scienter" refers to a mental state embracing intent to deceive, manipulate, or defraud. In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act. We need not address here the question whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10 (b) and Rule 10b-5.

Since this case concerns an action for damages we also need not consider the question whether scienter is a necessary element in an

[*Footnote 13 is on p. 8*]

II

Federal regulation of transactions in securities emerged as part of the aftermath of the market crash in 1929. The Securities Act of 1933 (1933 Act), 48 Stat. 74, as amended 15 U. S. C. § 77a *et seq.*, was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing. See H. R. Rep. No. 85, 73d Cong., 1st Sess., 1–5 (1933). The 1934 Act was intended principally to protect investors against manipulation of stock prices through regulation of transactions upon securities exchanges and in over-the-counter markets, and to impose regular reporting requirements on companies whose stock is listed on national securities exchanges. See S. Rep. No. 792, 73d Cong., 2d Sess., 1–5 (1934). Although the Acts contain numerous carefully drawn express civil remedies and criminal penalties, Congress recognized that efficient regulation of securities trading could not be accomplished under a rigid statutory program. As part of the

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action for injunctive relief under § 10 (b) and Rule 10b–5. Cf. *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180 (1963).

[13] Respondents further contend that Ernst & Ernst owed them a direct duty under § 17 (a) and Rule 17a–5 of the 1934 Act to conduct a proper audit of First Securities and that they may base a private cause of action against Ernst & Ernst for violation of that duty. Respondents cause of action, however, was premised solely on the alleged violation of § 10 (b) and Rule 10b–5. During the lengthy history of this litigation they have not amended their original complaint to aver a cause of action under § 17 (a) and Rule 17a–5. We therefore do not consider that a claim of liability under § 17 (a) is properly before us even assuming respondents could assert such a claim independently of § 10 (b).

1934 Act Congress created the Commission, which is provided with an arsenal of flexible enforcement powers. See, *e. g.*, 1933 Act §§ 8, 19, 20, 48 Stat. 79, 85, 86, as amended, 15 U. S. C. §§ 77h, 77s, 77t; 1934 Act §§ 9, 19, 21, 48 Stat. 889, 898, 899, as amended, 15 U. S. C. §§ 78i, 78s, 78u.

Section 10 of the 1934 Act makes it "unlawful for any person . . . (b) [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U. S. C. § 78j. In 1942, acting pursuant to the power conferred by § 10 (b), the Commission promulgated Rule 10b–5, which now provides:

> "Employment of manipulative and deceptive devices.
>
> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> "(1) To employ any device, scheme, or artifice to defraud,
>
> "(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> "(3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

Although § 10 (b) does not by its terms create an express civil remedy for its violation, and there is no

indication that Congress,[14] or the Commission when adopting Rule 10b–5,[15] contemplated such a remedy, the existence of a private cause of action for violations of the statute and the rule is now well established. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U. S. 723, 730 (1975); *Affiliated Ute Citizens* v. *United States,* 406 U. S. 128, 150–154 (1972); *Superintendent of Insurance* v. *Bankers Life and Casualty Co.,* 404 U. S. 6, 13 n. 9 (1971). During the 30-year period since a private cause of action was first implied under § 10 (b) and Rule 10b–5,[16] a substantial body of case law and commentary has developed as to its elements. Courts and commentators long have differed with regard to whether scienter is a necessary element of such a cause of action, or whether negligent conduct alone is sufficient.[17] In addressing this question, we turn first to the language of § 10 (b), for "[t]he starting point in every case involving construction of a statute is the language itself." *Blue Chip Stamps, supra,* at 756 (POWELL, J., concurring); *e. g., FTC* v. *Bunte Brothers, Inc.,* 312 U. S. 349, 350 (1941).

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[14] See, *e. g.,* S. Rep. No. 792, 73d Cong., 2d Sess., 5–6 (1934); Note, Implied Liability Under the Securities Exchange Act, 61 Harv. L. Rev. 858, 860 (1948).

[15] SEC Securities Exchange Release No. 3230 (1942); *Birnbaum* v. *Newport Steel Corp.,* 193 F. 2d 461, 463 (CA2), cert. denied, 343 U. S. 956 (1952).

[16] *Kardon* v. *National Gypsum Co.,* 69 F. Supp. 512 (ED Pa. 1946).

[17] See cases cited in n. 12, *supra.* Compare, *e. g.,* Comment, Scienter and Rule 10b–5, 69 Col. L. Rev. 1057, 1080–1081 (1969); Note, Negligent Misrepesentations under Rule 10b–5, 32 Chi. L. Rev. 824, 839–844 (1965); Note, 82 Harv. L. Rev. 938, 947 (1969); Note, Civil Liability Under Section 10B and Rule 10B–5: A Suggestion for Replacing the Doctrine of Privity, 74 Yale L. J. 658, 682–689 (1965), with, *e. g.,* 3 L. Loss, Securities Regulation 1766 (2d ed. 1961), 6 *id.* at 3883–3885 (Supp. 1969).

A

Section 10 (b) makes unlawful the use or employment of "any manipulative or deceptive device or contrivance" in contravention of Commission rules. The words "manipulative or deceptive" used in conjunction with "device or contrivance" strongly suggest that § 10 (b) was intended to proscribe knowing or intentional misconduct. See *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 868 (CA2 1968) (Friendly, J., concurring), cert. denied *sub nom. Kline* v. *SEC*, 394 U. S. 976 (1969); Loss, Sumary Remarks, 30 Bus. Lawyer 163, 165 (1975). See also *Kohn* v. *American Metal Climax, Inc.*, 458 F. 2d 255, 280 (CA3 1972) (Adams, J., concurring).

In its *amicus curiae* brief, however, the Commission contends that nothing in the language "manipulative or deceptive device or contrivance" limits its operation to knowing or intentional practices.[18] In support of its view, the Commission cites the overall congressional purpose

[18] The Commission would not permit recovery upon proof of negligence in all cases. In order to harmonize civil liability under § 10 (b) with the express civil remedies contained in the 1933 and 1934 Acts, the Commission would limit the circumstances in which civil liability could be imposed for negligent violation of Rule 10b–5 to situations in which (i) the defendant knew or reasonably could forsee that the plaintiff would rely on his conduct, (ii) the plaintiff did in fact so rely, and (iii) the amount of the plaintiff's damages caused by the defendant's conduct was definite and ascertainable. Brief of *Amicus Curiae* 23–33. The Commission concludes that the present record does not establish these conditions since Ernst & Ernst could not reasonably have forseen that the financial statements of First Securities would induce respondents to invest in the escrow accounts, respondents in fact did not rely on Ernst & Ernst's audits, and the amount of respondents' damages was unascertainable. *Id.*, 33–36. Respondents accept the Commission's basic analysis of the operative language of the statute and rule, but reject these additional requirements for recovery for negligent violations.

in the 1933 and 1934 Acts to protect investors against false and deceptive practices that might injure them. See *Affiliated Ute Citizens* v. *United States, supra,* at 151; *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 404 U. S., at 11–12; *J. I. Case Co.* v. *Borak,* 377 U. S. 426, 432–433 (1964). See also *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U. S. 180, 195 (1963). The Commission then reasons that since the "effect" upon investors of given conduct is the same regardless of whether the conduct is negligent or intentional, Congress must have intended to bar all such practices and not just those done knowingly or intentionally. The logic of this effect-oriented approach would impose liability for wholly faultless conduct where such conduct results in harm to investors, a result the Commission would be unlikely to support. But apart from where its logic might lead, the Commission would add a gloss to the operative language of the statute quite different from its commonly accepted meaning. See, *e. g., Addison* v. *Holly Hill Fruit Products, Inc.,* 322 U. S. 607. 617–618 (1944).[19] The argument simply ignores the use of the words "manipulative," "device," and "contrivance," terms that make unmistakable a congressional intent to proscribe a type of conduct quite different from negligence.[20] Use of the

[19] "To let general words draw on some purpose is one thing. To draw on some unexpressed spirit outside the bounds of the normal meaning of words is quite another . . . . After all, legislation when not expressed in technical terms is addressed to the common run of men and is therefore understood according to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him." *Addison* v. *Holly Hill Fruit Products, Inc.,* 322 U. S. 607, 617–618 (1944). See Frankfurter, Some Reflections on the Reading of Statutes, 47 Col. L. Rev. 527, 536–537 (1947).

[20] Webster's Int'l Dictionary (2d ed. 1934) defines "device" as "[t]hat which is devised, or formed by design; a contrivance; an invention; project; scheme; often a scheme to deceive; a stratagem; an artifice," and "contrivance" in pertinent part as "[a] thing con-

word "manipulative" is especially significant. It is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.[21]

In addition to relying upon the Commission's argument with respect to the operative language of the statute, respondents contend that since we are dealing with "remedial legislation," *Tcherepnin* v. *Knight*, 389 U. S. 332, 336 (1967), it must be construed " 'not technically and restrictively, but flexibly to effectuate its remedial purposes.' " *Affiliated Ute Citizens* v. *United States*, *supra*, at 151, quoting *SEC* v. *Capital Gains Research Bureau*, *supra*, at 186. They argue that the "remedial purposes" of the Acts demand a construction of § 10 (b) that embraces negligence as a standard of liability. But in seeking to accomplish its broad remedial goals, Congress did not adopt uniformly a negligence standard even as to express civil remedies. In some circumstances and with respect to certain classes of defendants, Congress did create express liability predicated upon a failure to exercise reasonable care. *E. g.*, 1933 Act § 11 (b)(3)(B), 48 Stat. 82 as amended 15 U. S. C. § 77k (b)(3)(B) (liability of "experts," such as accountants, for misleading statements in portions of registration statements for which they are responsible).[22] But in other situations

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trived or used in contriving; a scheme, plan, or artifice." In turn, "contrive" in pertinent part is defined as "[t]o devise; to plan; to plot . . . [t]o fabricate . . . design; invent . . . to scheme . . . ." The Commission also ignores the use of the terms "[t]o use or employ," language that is supportive of the view that Congress did not intend § 10 (b) to embrace negligent conduct.

[21] Webster's Int'l Dictionary, *supra*, defines "manipulate" as ". . . to manage or treat artfully or fraudulently; as to *manipulate* accounts . . . 4. *Exchanges.* To force (prices) up or down, as by matched orders, wash sales, fictitious reports . . . ; to rig."

[22] See p. 21 & n. 26, *infra*.

good faith is an absolute defense. 1934 Act § 18, 48 Stat. 897, as amended 15 U. S. C. § 78r (misleading statements in any document filed pursuant to the 1934 Act). And in still other circumstances Congress created express liability regardless of the defendant's fault, 1933 Act § 11 (a) (issuer liability for misleading statements in the registration statement).

It is thus evident that Congress fashioned standards of fault in the express civil remedies in the 1933 and 1934 Acts on a particularized basis. Ascertainment of congressional intent with respect to the standard of liability created by a particular section of the Acts must therefore rest primarily on the language of that section. Where, as here, we deal with a judicially implied liability, the statutory language certainly is no less important. In view of the language of § 10 (b) which so clearly connotes intentional misconduct, and mindful that the language of a statute controls when sufficiently clear in its context, *United States* v. *Oregon,* 366 U. S. 643, 648 (1961); *Packard Motor Car Co.* v. *NLRB,* 330 U. S. 485, 492 (1947), further inquiry may be unnecessary. We turn now, nevertheless, to the legislative history of the 1934 Act to ascertain whether there is support for the meaning attributed to § 10 (b) by the Commission and respondents.

B

Although the extensive legislative history of the 1934 Act is bereft of any explicit explanation of Congress' intent, we think the relevant portions of that history support our conclusion that § 10 (b) was addressed to practices that involve some element of scienter and cannot be read to impose liability for negligent conduct alone.

The original version of what would develop into the 1934 Act was contained in identical bills introduced by

Senator Fletcher and Representative Rayburn. S. 2693, 73d Cong., 2d Sess. (1934); H. R. 7852, 73d Cong., 2d Sess. (1934). Section 9 (c) of the bills, from which present § 10 (b) evolved, proscribed as unlawful the use of "any device or contrivance which, or any device or contrivance in a way or manner which the Commission may by its rules and regulations find detrimental to the public interest or to the proper protection of investors." The other subsections of proposed § 9 listed specific practices that Congress empowered the Commission to regulate through its rulemaking power. See §§ 9 (a) (short sale), (b) ("stop-loss order"). Soon after the hearings on the House bill were held, a substitute bill was introduced in both Houses which abbreviated and modified § 9 (c)'s operative language to read "any manipulative device or contrivance." S. 3420, 73d Cong., 2d Sess., § 10 (b) (1934); H. R. 8720, 73d Cong., 2d Sess., 9 (c) (1934). Still a third bill, retaining the Commission's power to regulate the specific practices enumerated in the prior bills, and omitting all reference to the Commission's authority to prescribe rules concerning manipulative or deceptive devices in general, was introduced and passed in the House. H. R. 9323, 73d Cong., 2d Sess., § 9 (1934). The final language of § 10 is a modified version of a Senate amendment to this last House bill. See H. R. Rep. No. 1838, 73d Cong., 2d Sess., 32–33 (1934) (Conference Report).

Neither the intended scope of § 10 (b) nor the reasons for the changes in its operative language are revealed explicitly in the legislative history of the 1934 Act, which deals primarily with other aspects of the legislation. There is no indication, however, that § 10 (b) was intended to proscribe conduct not involving scienter. The extensive hearings that preceded passage of the 1934 Act touched only briefly on § 10, and most of the discussion was devoted to the enumerated devices that the

Commission is empowered to proscribe under § 10 (a). The most relevant exposition of the provision that was to become § 10 (b) was by Thomas G. Corcoran, a spokesman for the drafters. Corcoran indicated:

> "Subsection (c) [§ 9 (c) of H. R. 7852—later § 10 (b)] says, 'Thou shalt not devise any other cunning devices.' . . .
>
> "Of course subsection (c) is a catch-all clause to prevent manipulative devices. I do not think there is any objection to that kind of clause. The Commission should have the authority to deal with new manipulative devices."

Hearings on H. R. 7852 and H. R. 8720 before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 115 (1934). This brief explanation of § 10 (b) by a spokesman for its drafters is significant. The section was described rightly as a "catch-all" clause to enable the Commission "to deal with new manipulative [or cunning] devices." It is difficult to believe that any lawyer, legislative draftsman, or legislator would use these words if the intent was to create liability for merely negligent acts or omissions.[23] Neither the legislative history nor the briefs supporting respondents identify any usage or authority for construing "manipulative [or cunning] devices" to include negligence.[24]

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[23] See n. 21, *supra*.

[24] In support of its position the Commission cites statements by Corcoran in the Senate hearings that "in modern society there are many things you have to make crimes which are sheer matters of negligence" and "intent is not necessary for every crime." Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., 6509–6510 (1934). The comments, taken in context, shed no light on the meaning of § 10 (b). Corcoran's remarks were made during a discussion of whether criminal violations could arise under § 8 (a)(3) of S. 2693, 73d Cong., 2d

The legislative reports do not address the scope of § 10 (b) or its catch-all function directly. In considering specific manipulative practices left to Commission regulation, however, the reports indicate that liability would not attach absent scienter, supporting the conclusion that Congress intended no lesser standard under § 10 (b). The Senate Report of S. 3420 discusses gener-

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Sess., which in material part was incorporated in § 9 of the 1934 Act, 15 U. S. C. § 78i, in the absence of specific intent to influence security prices for personal gain. The remarks, moreover, were not addressed to the scope of § 8, but were general observations concerning activity society might proscribe under criminal law. Ferdinand Pecora, counsel to the committee and a draftman of S. 2693, *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, — U. S. —, — n. 24 (1976), described the language as "[e]xcluding from its scope an act that is not done with any ulterior motives or purposes, as set forth in the act." *Id.*, at 6510. Further, prior to the passage of the 1934 Act, proposed § 8 was amended to require willful behavior as a prerequisite to civil liability for violations. Compare § 9 (e) of the 1934 Act with § 8 (c) of S. 2693. See H. R. Rep. No. 1383, 73d Cong., 2d Sess., 21 (1934).

The Commission also relies on objections to a draft version of § 10 (b)—§ 9 (c) of S. 2693 and H. R. 7852, see pp. 14–15, *supra*—raised by representatives of the securities industry in the House and Senate hearings. They warned that the language was so vague that the Commission might outlaw anything. *E. g.*; Hearings on Stock Exchange Practices, *supra*, at 6988; Hearings on H. R. 7852 and H. R. 8720 before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 258 (1934). Remarks of this kind made in the course of legislative debate or hearings other than by persons responsible for the preparation or the drafting of a bill, are entitled to little weight. See, *e. g.*, *United States* v. *United Mine Workers*, 330 U. S. 258, 276–277 (1947); *United States* v. *Wrightwood Dairy Co.*, 315 U. S. 110, 125 (1942). This is especially so with regard to the statements of legislative opponents who "[i]n their zeal to defeat a bill . . . understandably tend to overstate its reach." *NLRB* v. *Fruit Packers*, 377 U. S. 58, 66 (1964). See *Schwegmann Bros.* v. *Calvert Distillers Corp.*, 341 U. S. 384, 394–395 (1951).

ally the various abuses that precipitated the need for the legislation and the inadequacy of self-regulation by the stock exchanges. The Report then analyzes the component provisions of the statute, but does not parse § 10. The only specific reference to § 10 is the following:

> "In addition to the discretionary and elastic powers conferred on the administrative authority, effective regulation must include several clear statutory provisions reinforced by penal and civil sanctions, aimed at those manipulative and deceptive practices which have been demonstrated to fulfill no useful function. These sanctions are found in sections 9, 10 and 16." S. Rep. 792, 73d Cong., 2d Sess., 6 (1934).

In the portion of the general analysis section of the Report entitled "Manipulative Practices," however, there is a discussion of specific practices that were considered so inimical to the public interest as to require express prohibition, such as "wash" sales and "matched" orders,[25] and of other practices that might in some cases serve legitimate purposes, such as stabilization of security prices and grants of options. *Id.*, at 7–9. These latter practices were left to regulation by the Commission. 1934 Act §§ 9 (a)(6), (c), 48 Stat. 890, 15 U. S. C. §§ 78*i* (a)(6), (c). Significantly, we think, in the discussion of

[25] "Wash" sales are transactions involving no change in beneficial ownership. "Matched" orders are orders for the purchase/sale of a security that are entered with the knowledge that orders of substantially the same size, at substantially the same time and price, have been or will be entered by the same or different persons for the sale/purchase of such security. Section 9 (a)(1) of the 1934 Act, 15 U. S. C. § 78*i* (a)(1), proscribes wash sales and matched orders when effectuated "[f]or the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange, or . . . with respect to the market for any such security." See *In re J. A. Latimer & Co.*, 38 S. E. C. 790 (1958); *In re Thornton & Co.*, 28 S. E. C. 208 (1948).

the need to regulate even the latter category of practices when they are manipulative, there is no indication that any type of criminal or civil liability is to attach in the absence of scienter. Furthermore, in commenting on the express civil liabilities provided in the 1934 Act, the Report explains:

> ". . . if an investor has suffered loss by reason of illicit practices, it is equitable that he should be allowed to recover damages from the guilty party. . . . The bill provides that any person who unlawfully manipulates the price of a security, or who induces transactions in a security by means of false or misleading statements, or who makes a false or misleading statement in the report of a corporation, shall be liable in damages to those who have bought or sold the security at prices affected by such violation or statement. In such case the burden is on the plaintiff to show the violation or the fact that the statement was false or misleading, and that he relied thereon to his damage. The defendant may escape liability by showing that the statement was made in *good faith*." *Id.*, at 12–13 (emphasis supplied).

The Report therefore reveals with respect to the specified practices, an overall congressional intent to prevent "manipulative and deceptive practices . . . which fulfill no useful function" and to create private actions for damages stemming from "illicit practices," where the defendant has not acted in good faith. The views expressed in the House Report are consistent with this interpretation. H. Rep. No. 1383, 73d Cong., 2d Sess., 10–11, 20–21 (1934) (H. R. 9323). There is no indication that Congress intended anyone to be made liable for such practices unless he acted other than in good faith. The catch-all provision of § 10 (b) should be interpreted no more broadly.

C

The 1933 and 1934 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities. See *Blue Chip Stamps,* 421 U. S., at 727–730. As the Court indicated in *SEC* v. *National Securities, Inc.,* 393 U. S. 453 (1969), "the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen. . . ." Recognizing this, respondents and the Commission contrast § 10 (b) to other sections of the Acts to support their contention that civil liability may be imposed upon proof of negligent conduct. We think they misconceive the significance of the other provisions of the Acts.

The Commission argues that Congress has been explicit in requiring willful conduct when that was the standard of fault intended, citing § 9 of the 1934 Act, 48 Stat. 889, 15 U. S. C. § 78*i*, which generally proscribes manipulation of securities prices. Sections 9 (a)(1) and (a)(2), for example, respectively prohibit manipulation of security prices "[f]or the purpose of creating a false or misleading appearance of actual trading in any security . . . or . . . with respect to the market for any such security," and "for the purpose of including the purchase or sale of such security by others." See also § 9 (a)(4). Section 9 (e) then imposes upon "[a]ny person who willfully participates in any act or transaction in violation of" other provisions of § 9 civil liability to anyone who purchased or sold a security at a price affected by the manipulative activities. From this the Commission concludes that since § 10 (b) is not by its terms explicitly restricted to willful, knowing, or purposeful conduct, it should not be construed in all cases to require more than negligent action or inaction as a precondition for civil liability.

The structure of the Acts does not support the Com-

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mission's argument. In each instance that Congress created express civil liability in favor of purchasers or sellers of securities it clearly specified whether recovery was to be premised on knowing or intentional conduct, negligence, or entirely innocent mistake. See 1933 Act, §§ 11, 12, 15, 48 Stat. 82, 84, as amended 15 U. S. C. §§ 77k, 77*l*, 77o; 1934 Act §§ 9, 18, 20, 48 Stat. 889, 897, 899, as amended 15 U. S. C. §§ 78i, 78r, 78t. For example, § 11 of the 1933 Act unambiguously creates a private action for damages when a registration statement includes untrue statements of material facts or fails to state material facts necessary to make the statements therein not misleading. Within the limits specified by § 11 (e), the issuer of the securities is held absolutely liable for any damages resulting from such misstatement or omission. But experts such as accountants who have prepared portions of the registration statement are accorded a "due diligence" defense. In effect, this is a negligence standard. An expert may avoid civil liability with respect to the portions of the registration statement for which he was responsible by showing that "after reasonable investigation" he had "reasonable ground[s] to believe" that the statements for which he was responsible were true and there was no omission of a material fact.[26] § 11 (b)(3)(B)(i). See, *e. g., Escott* v.

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[26] Other individuals who sign the registration statement, directors of the issuer, and the underwriter of the securities similarly are accorded a complete defense against civil liability based on the exercise of reasonable investigation and a reasonable belief that the registration statement was not misleading. §§ 11 (b)(3)(A), (C), (D), (c). See, *e. g., Feit* v. *Leasco Data Processing Equipment Corp.*, 332 F. Supp. 544, 575–583 (EDNY 1971) (underwriters, but not officer-directors, established their due diligence defense). See generally R. Jennings & H. Marsh, Securities Regulation 1018–1027 (3d ed. 1972), and sources cited therein; Folk, Civil Liabilities under the Federal Securities Acts: The Barchris Case, 55 Va. L. Rev. 199 (1969).

Barchris Construction Corp., 283 F. Supp. 643, 697–703 (SDNY 1968). The express recognition of a cause of action premised on negligent behavior in § 11 stands in sharp contrast to the language of § 10 (b), and significantly undercuts the Commission's argument.

We also consider it significant that each of the express civil remedies in the 1933 Act allowing recovery for negligent conduct, see §§ 11, 12 (2), 15, 15 U. S. C. §§ 77k, 77*l*, 77o,[27] is subject to significant procedural restrictions not applicable under § 10 (b).[28] Section 11 (e) of the 1933

[27] Section 12 (2) creates potential civil liability for a seller of securities in favor of the purchaser for misleading statements or omissions in connection with the transaction. The seller is exculpated if he proves that he did not know, or in the exercise of reasonable care, could not have known of the untruth or omission. Section 15 of the 1933 Act, as amended by § 208 of Title II of the 1934 Act, makes persons who "control" any person liable under § 11 or § 12 liable jointly and severally to the same extent as the controlled person, unless he "had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." 15 U. S. C. § 77o. See Act of June 6, 1934, Pub. L. No. 291, c. 404, Title II § 208, 48 Stat. 908.

[28] Each of the provisions of the 1934 Act that expressly create civil liability, except those directed to specific classes of individuals such as directors, officers, or 10% beneficial holders of securities, see § 16 (b), 15 U. S. C. § 78p, *Foremost-McKesson, Inc.* v. *Provident Securities Co., supra; Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U. S. 582 (1973), contains a state-of-mind condition requiring something more than negligence. Section 9 creates potential civil liability for any person who "willfully participates" in the manipulation of securities on a national exchange. § 9 (e). 15 U. S. C. § 78*i* (e). Section 18 creates potential civil liability for misleading statements filed with the Commission, but provides the defendant with the defense that "he acted in good faith and had no knowledge that such statement was false or misleading." 15 U. S. C. § 78r. And § 20, which imposes liability upon "controlling persons" for violations of the Act by those they control, exculpates a defendant who "acted in good faith and did not . . . induce the act . . .

Act, for example, authorizes the court to require a plaintiff bringing a suit under § 11, § 12 (2), or § 15 thereof to post a bond for costs, including attorneys' fees and in specified circumstances to assess costs at the conclusion of the litigation. Section 13 specifies a statute of limitations of one year from the time the violation was or should have been discovered, in no event to exceed three years from the time of offer or sale, applicable to actions brought under § 11, § 12 (2), or § 15. These restrictions, significantly, were imposed by amendments to the 1933 Act adopted as part of the 1934 Act. Prior to amendment § 11 (e) contained no provision for payment of costs. 48 Stat. 83. Act of May 27, 1933, Pub. L. No. 22, c. 38, Title I, § 11 (e). See Act of June 6, 1934, Pub. L. No. 291, c. 404, Title II § 206 (e), 48 Stat. 908. The amendments also substantially shortened the statute of limitations provided by § 13. Compare Pub. L. No. 22, *supra,* § 13, 48 Stat. 84, with 15 U. S. C. § 77m. See 1934 Act, § 207, 48 Stat. 908. We think these procedural limitations indicate that the judicially created private damage remedy under § 10 (b)—which has no comparable restrictions [29]—cannot be

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constituting the violation. . . ." 15 U. S. C. § 78t. Emphasizing the important difference between the operative language and purpose of § 14 (a) of the 1934 Act, 15 U. S. C. § 14n (a), as contrasted with § 10 (b), however, some courts have concluded that proof of scienter is unnecessary in an action for damages by the shareholder recipients of a materially misleading proxy statement against the issuer corporation. *Gerstle* v. *Gamble-Skogmo, Inc.,* 478 F. 2d 1281, 1299 (CA2 1973). See also *Kohn* v. *American Metal Climax, Inc., supra,* at 289–290.

[29] Since no statute of limitations is provided for civil actions under § 10 (b), the law of limitations of the forum state is followed as in other cases of judicially implied remedies. See *Holmberg* v. *Armbrecht,* 327 U. S. 392, 395 (1946), and cases cited therein. Although it is not always certain which state statute of limitations should be followed, such statutes of limitations usually are longer

extended, consistently with the intent of Congress, to actions premised on negligent wrongdoing. Such extension would allow causes of action covered by § 11, § 12 (2), and § 15 to be brought instead under § 10 (b) and thereby nullify the effectiveness of the carefully drawn procedural restrictions on these express actions.[30] See, *e. g., Fischman* v. *Raytheon Manufacturing Co.,* 188 F. 2d 783, 786–787 (CA2 1951); *SEC* v. *Texas Gulf Sulphur Co.,* 401 F. 2d, at 867–868 (Friendly, J., concurring); *Rosenberg* v. *Globe Aircraft Corp.,* 80 F. Supp. 123, 124 (ED Pa. 1948); 3 L. Loss, Securities Regulation 1787–1788 (2d ed. 1961); R. Jennings & H. Marsh, Securities Regulation 1070–1074 (3d ed. 1972). We would be unwilling to bring about this result absent substantial support in the legislative history, and there is none.[31]

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than the period provided under § 13. 3 L. Loss, *supra,* at 1773–1774. As to costs see n. 30 *infra.*

[30] Congress regarded these restrictions on private damage actions as significant. In introducing Title II of the 1934 Act, Senator Fletcher indicated that the amendment to § 11 (e) of the 1933 Act, providing for potential payment of costs, including attorneys' fees, "is the most important [amendment] of all." 78 Cong. Rec. 8669. One of its purposes was to deter actions brought solely for their potential settlement value. See *ibid.;* H. Rep. 1838, 73d Cong., 2d Sess., 42 (1934) (Conference Report); *Blue Chip Stamps, supra,* at 740–741. This deterrent is lacking in the § 10 (b) context, in which a district court's power to award attorneys' fees is sharply circumscribed. See *Alyeska Pipeline Service Co.* v. *Wilderness Society,* 421 U. S. 240 (1975) ("bad faith" requirement); *F. D. Rich Co.* v. *Industrial Lumber Co.,* 417 U. S. 116, 129 (1974).

[31] Section 18 of the 1934 Act creates a private cause of action against persons, such as accountants, who "make or cause to be made" materially misleading statements in reports or other documents filed with the Commission. 15 U. S. C. § 78r. We need not consider the question whether a cause of action may be maintained under § 10 (b) on the basis of actions that would constitute a violation of § 18. Under § 18 liability extends to persons who, in reliance on such statements, purchased or sold a security whose price

D

We have addressed, to this point, primarily the language and history of § 10 (b). The Commission contends, however, that subsections (2) and (3) of Rule 10b–5 are cast in language which—if standing alone—could encompass both intentional and negligent behavior. These subsections respectively provide that it is unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading . . ." and "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. . . ." Viewed in isolation the language of subsection (2), and arguably that of subsection (3), could be read as proscribing, respectively, any type of material misstatement or omission, and any

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was affected by the statements. Liability is limited, however, in the important respect that the defendant is accorded the defense that he acted in "good faith and had no knowledge that such statement was false or misleading." Consistent with this language the legislative history of the section suggests something more than negligence on the part of the defendant is required for recovery. The original version of § 18 (a), § 17 (a) of S. 2693, H. R. 7852 and H. R. 7855, see pp. 14–15, *supra,* provided that the defendant would not be liable if "he acted in good faith and in the exercise of reasonable care had no ground to believe that such statement was false or misleading." The accounting profession objected to this provision on the ground that liability would be created for honest errors in judgment. See Senate Hearings on Stock Exchange Practices, *supra,* at 7175–7183; House Hearings on H. R. 7852 and H. R. 8720, *supra,* at 653. In subsequent drafts the current formulation was adopted. It is also significant that actions under § 18 are limited by a relatively short statute of limitations similar to that provided in § 13 of the 1933 Act. § 18 (c). Moreover, as under § 11 (e) of the 1933 Act the District Court is authorized to require the plaintiff to post a bond for costs, including attorney's fees, and to assess such costs at the conclusion of the litigation. § 18 (a).

course of conduct, that has the effect of defrauding investors, whether the wrongdoing was intentional or not.

We note first that such a reading cannot be harmonized with the administrative history of the rule, a history making clear that when the Commission adopted the rule it was intended to apply only to activities that involved scienter.[32] More importantly, Rule 10b–5 was

[32] Apparently the rule was a hastily drafted response to a situation clearly involving intentional misconduct. The Commission's Regional Administrator in Boston had reported to the Director of the Trading and Exchange Division that the president of a corporation was telling the other shareholders that the corporation was doing poorly and purchasing their shares at the resultant depressed prices, when in fact the business was doing exceptionally well. The Rule was drafted and approved on the day this report was received. See Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967) (remarks of Milton Freeman, one of rule's co-drafters); *Blue Chip Stamps, supra,* at 767 (BLACKMUN, J., dissenting). Although adopted pursuant to § 10 (b), the language of the rule appears to have been derived in significant part from § 17 of the 1933 Act, 15 U. S. C. § 77q. *E. g., ibid.; SEC* v. *Texas Gulf Sulphur Co.,* 401 F. 2d, 833, 867 (CA2 1968) (Friendly, J., concurring), cert. denied *sub nom. Kline* v. *SEC,* 394 U. S. 976 (1969). There is no indication in the administrative history of the Rule that any of the subsections was intended to proscribe conduct not involving scienter. Indeed the Commission's release issued contemporaneously with the rule explained:

"The Securities and Exchange Commission today announced the adoption of a rule prohibiting fraud by any person in connection with the purchase of securities. The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase." SEC Release No. 3230 (May 21, 1942).

That same year, in its Annual Report, the Commission again stated that the purpose of the rule was to protect investors against "fraud":

"During the fiscal year the Commission adopted Rule X-10B-5 as an additional protection to investors. The new rule prohibits fraud by any person in connection with the purchase of securities,

adopted pursuant to authority granted the Commission under § 10 (b). The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is " 'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.' " *Dixon* v. *United States,* 381 U. S. 68, 74 (1965), quoting *Manhattan General Equipment Co.* v. *Commissioner,* 297 U. S. 129, 134 (1936). Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10 (b). For the reasons stated above, we think the Commission's original interpretation of Rule 10b–5 was compelled by the language and history of § 10 (b) and related sections of the Acts. See, *e. g., Gerstle* v. *Gamble-Skogmo, Inc.,* 478 F. 2d 1281, 1299 (CA2 1973); *Lanza* v. *Drexel & Co.,* 479 F. 2d 1277, 1304–1305 (CA2 1973); *SEC* v. *Texas Gulf Sulphur Co., supra,* at 868; 3 L. Loss, *supra,* 1766; 6 *id.,* at 3883–3885 (Supp. 1969). When a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances—the commonly understood terminology of intentional wrongdoing—and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct.[33]

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while the previously existing rules against fraud in the purchase of securities applied only to brokers and dealers." 8 SEC Ann. Rep. 10 (1942).

[33] As we find the language and history of § 10 (b) dispositive of the appropriate standard of liability, there is no occasion to examine the additional considerations of "policy," set forth by the parties, that may have influenced the lawmakers in their formulation of the statute. We do note that the standard urged by respondents would significantly broaden the class of plaintiffs who may seek to impose liability upon accountants and other experts who perform services or

III

Recognizing that § 10 (b) and Rule 10b-5 might be held to require proof of more than negligent nonfeasance by Ernst & Ernst as a precondition to the imposition of civil liability, respondents further contend that the case should be remanded for trial under whatever standard is adopted. Throughout the lengthy history of this case respondents have proceeded on a theory of liability premised on negligence, specifically disclaiming that Ernst & Ernst had engaged in fraud or intentional misconduct.[34] In these circumstances, we think it inappropriate to remand the action for further proceedings.

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express opinions with respect to matters under the Acts. Last Term, in *Blue Chip Stamps, supra,* at 747-748, the Court pertinently observed:

"While much of the development of the law of deceit has been the elimination of artificial barriers to recovery on just claims, we are not the first court to express concern that the inexorable broadening of the class of plaintiffs who may sue in this area of the law will ultimately result in more harm than good. In *Ultramares Corp.* v. *Touche,* 255 N. Y. 170, 174 N. E. 441 (1931), Chief Judge Cardozo observed with respect to 'a liability in an indeterminate amount for an indeterminate time to an indeterminate cause':

" 'The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.' *Id.,* at 179-180, 174 N. E., at 444."

This case, on its facts, illustrates the extreme reach of the standard urged by respondents. As investors in transactions initiated by Nay, not First Securities, they were not foreseeable users of the financial statements prepared by Ernst & Ernst. Respondents conceded that they did not rely on either these financial statements or Ernst & Ernst's certificates of opinion. See n. 9, *supra.* The class of persons eligible to benefit from such a standard, though small in this case, could be numbered in the thousands in other cases. Acceptance of respondents' view would extend to new frontiers the "hazards" of rendering expert advice under the Acts, raising serious policy questions not yet addressed by Congress.

[34] See 503 F. 2d, at 1104, 1119; n. 5, *supra.*

The judgment of the Court of Appeals is

Reversed.

MR. JUSTICE STEVENS took no part in the consideration or decision of this case.

SUPREME COURT OF THE UNITED STATES

No. 74-1042

Ernst & Ernst, Petitioner, *v.* Olga Hochfelder et al.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[March 30, 1976]

MR. JUSTICE BLACKMUN, with whom MR. JUSTICE BRENNAN joins, dissenting.

Once again—see *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U. S. 723, 730 (1975)—the Court interprets § 10 (b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j (b), and the Securities and Exchange Commission's Rule 10b–5, 17 CFR § 240.10b–5 (1975), restrictively and narrowly and thereby stultifies recovery for the victim. This time the Court does so by confining the statute and the Rule to situations where the defendant has "scienter," that is, the "intent to deceive, manipulate, or defraud." Sheer negligence, the Court says, is not within the reach of the statute and the Rule, and was not contemplated when the great reforms of 1933, 1934, and 1942 were effectuated by Congress and the Commission.

Perhaps the Court is right, but I doubt it. The Government and the Commission doubt it too, as is evidenced by the thrust of the brief filed by the Solicitor General on behalf of the Commission, as *amicus curiae.* The Court's opinion, *ante,* to be sure, has a certain technical consistency about it. It seems to me, however, that an investor can be victimized just as much by negligent conduct as by positive deception, and that it is not logical to drive a wedge between the two, saying that Congress clearly intended the one but certainly not the other.

No one questions the fact that the respondents here were the victims of an intentional securities fraud practiced by Leston B. Nay. What is at issue, of course, is the petitioner-accountant firm's involvement and that firm's responsibility under Rule 10b–5. The language of the Rule, making it unlawful for any person "in connection with the purchase or sale of any security"

> "(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> "(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,"

seems to me, clearly and succinctly, to prohibit negligent as well as intentional conduct of the kind proscribed, to extend beyond common law fraud, and to apply to negligent omission and commission. This is consistent with Congress' intent, repeatedly recognized by the Court, that securities legislation enacted for the purpose of avoiding frauds be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes." *SEC* v. *Capital Gains Research Bureau,* 375 U. S. 180, 195 (1963); *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 404 U. S. 6, 12 (1971); *Affiliated Ute Citizens* v. *United States,* 406 U. S. 128, 151 (1972).

On motion for summary judgment, therefore, the respondents' allegations, in my view, were sufficient, and the District Court's dismissal of the action was improper to the extent that the dismissal rested on the proposition that suit could not be maintained under § 10 (b) and Rule 10b–5 for mere negligence. The opposite appears to be true, at least in the Second Circuit, with respect to

suits by the SEC to enjoin a violation of the Rule. *SEC* v. *Management Dynamics, Inc.*, 515 F. 2d 881 (1975); *SEC* v. *Spectrum, Ltd.*, 489 F. 2d 535, 541 (1973); *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 854–855 (1968), cert. denied *sub nom. Kline* v. *SEC*, 394 U. S. 976 (1969). I see no real distinction between that situation and this one, for surely the question whether negligent conduct violates the Rule should not depend upon the plaintiff's identity. If negligence is a violation factor when the SEC sues, it must be a violation factor when a private party sues. And, in its present posture, this case is concerned with the issue of violation, not with the secondary issue of a private party's judicially created entitlement to damages or other specific relief. See *Rondeau* v. *Mosinee Paper Corp.*, 422 U. S. 49 (1975).

The critical importance of the auditing accountant's role in insuring full disclosure cannot be overestimated. The SEC has emphasized that in certifying statements the accountant's duty "is to safeguard the public interest, not that of his client." *In re Touche, Niven, Bailey & Smart,* 37 S. E. C. 629, 670–671 (1957). "In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar." *United States* v. *Benjamin,* 328 F. 2d 854, 863 (CA2), cert. denied *sub nom. Howard* v. *United States,* 377 U. S. 953 (1964). In this light, the initial inquiry into whether Ernst & Ernst's preparation and certification of the financial statements of First Securities Company of Chicago were negligent, because of the failure to perceive Nay's extraordinary mail rule, and in other alleged respects, and thus whether Rule 10b–5 was violated, should not be thwarted.

But the Court today decides that it is to be thwarted; and so once again it rests with Congress to rephrase and

to re-enact, if investor victims, such as these, are ever to have relief under the federal securities laws that I thought had been enacted for their broad, needed, and deserving benefit.*

*The Court, understandably, does not resolve a number of other issues suggested by the Briefs. See nn. 7, 11, 12, 13, and 33, *ante.* In view of the result reached by the Court, no purpose would be served by my considering those issues in dissent.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHIEF ACCOUNTANT

August 9, 1976

Jack Chesson, Esq.
Counsel
Subcommittee on Reports, Accounting
& Management
United States Senate
161 Russell Office Building
Washington, D.C. 20510

Dear Jack:

At lunch a while ago, you asked if I could advise you of the various committees with which the staff and the Commissioners met from time to time on accounting matters.

In this connection, you are, I am sure, aware that the Commission and staff are generally willing to meet with almost any group that seeks such a meeting, so long as such a meeting does not run afoul of any substantive or procedural requirements to which the Commission is subject, such as the Federal Advisory Committee Act. Some groups are made up on an ad hoc basis to deal generally with a given subject.

I believe, however, that you indicated a primary interest in groups we met with other than on a single issue. There are a number of committees of several organizations that hold their meetings in Washington and invite SEC representatives to meet with them for part of their meetings or who send subcommittees to meet with us, both so as to learn our views and let us hear their's, and to get to know us on a personal basis. I find these meetings generally worthwhile as they enable us to identify problems at early stages and they give us the opportunity to know senior officers of these organizations. The following committees have been involved:

American Institute of CPAs
- Committee on SEC Regulation
- Auditing Standards Executive Committee
- "Group C" Executive Committee (Group C firms are the large firms with significant public practices)
- Accounting Standards Executive Committee

Financial Executives Institute
Board of Directors
Corporate Reporting Committee (SEC subcommittee)

Financial Accounting Standards Board (the full Board meets with the Commission from time to time)

Financial Analysts Federation
Bank Analysts Group

In addition, there are many different groups to which we send staff observers or participants, such as the FASB task forces, the Financial Accounting Standards Advisory Council and the American Petroleum Institute Research Study on Replacement Cost.

With the exception of the AICPA Committee on SEC Regulation which meets quarterly and the FEI Corporate Reporting Committee which meets with us three times a year, the above groups do not meet with us regularly, but on a from time to time basis.

If I can give you any additional information, please give me a call.

Cordially,

Sandy

John C. Burton
Chief Accountant

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ARTHUR ANDERSEN & COMPANY,	)	
Plaintiff,	)	
vs.	)	No. 76 C 2832
SECURITIES & EXCHANGE COMMISSION,	)	
Defendant.	)	

TRANSCRIPT OF PROCEEDINGS

had in the hearing of the above-entitled cause before the HONORABLE PRENTICE H. MARSHALL, one of the Judges of said Court, in his courtroom in the United States Courthouse, Chicago, Illinois, on Friday, September 3, 1976, at 9:00 o'clock a.m.

PRESENT:

MESSRS. WILSON & McILVAINE,
(135 South LaSalle Street, Chicago, IL) by:
CHARLES W. BOAND, Esq., and
LEONARD SHIFFLETT, Esq.,

on behalf of plaintiff;

WILLIAM M. HEGAN, Esq.,
Assistant Regional Administrator,
Securities & Exchange Commission, Chicago, IL.,

on behalf of defendant;

MESSRS. POPE, BALLARD, SHEPARD & FOWLE,
(69 West Washington St., Chicago, IL) by:

WILLIAM E. KELLY, Esq.,

appearing as amicus curiae;

AND VARIOUS UNIDENTIFIED COUNSEL.

THE CLERK: 76 C 2832, Arthur Andersen vs Securities & Exchange Commission, for decision.

THE COURT: Good morning, gentlemen. Why don't you remain seated. I had hoped that I would have something written for you this morning, but the aftermath of my tour as emergency judge required me to do some writing, and I just -- I've got something outlined here, and I will give it to you orally. If any of the parties desire review of the decision, the reporter will transcribe it for you and I will sign it as written findings and conclusions.

This is an action brought by the plaintiff, Arthur Andersen & Company against the defendant Securities & Exchange Commission seeking relief under 28 USC Section 2201, and an injunction pendente lite under Rule 65 of the Federal Rules of Civil Procedure.

Jurisdiction is here under 28 USC Section 1331, upon Sections 10(a) and (b) of the Administrative Procedure Act, 5 US Code, Section 702 and 703; upon Section 22 of the Securities Act of 1933, 15 US Code, Section 77(v) and Section 27 of the Securities & Exchange Act of 1934, 15 USC, Section 78(a)(A).

Defendant's alleged wrong is said to consist of violations of the rule-making provisions of the Administrative Procedure Act, 5 USC, Sections 553 and 706 of the SEC's own rule-making regulations which are found in 17 CFR, Section

202.6 and generally of the laws and Constitution of the United States.

The plaintiff, Arthur Andersen & Company, is a general partnership organized and existing under the laws of the State of Illinois with its principal office located in Chicago. It is a firm of independent public accountants. The firm's activities include the examination of and reporting on the financial statements of business enterprises and public bodies. Many of the firm's clients are subject to the jurisdiction of the SEC and are required to include financial statements together with Arthur Andersen's audit reports thereon and filings under the various Acts which are administered and enforced by the SEC. These filings include, but are not limited to registration statements filed pursuant to the Securities Act of 1933 and annual and periodic reports and proxy statements filed pursuant to the Securities Exchange Act of 1934.

In all of these filings, the plaintiff is required to observe the rules and regulations promulgated by the SEC which govern the form and content of financial statements; in particular, the plaintiff is required to observe the SEC's Regulation SX governing accounting presentations and filings with the SEC, Rule 202(c) of Regulation SX, all of which is found in 17 CFR, Section 210.1-01 and following requires plaintiff to express an opinion relating to the financial

statements filed by its clients with the SEC and the accounting principles and practices reflected therein.

The rule does not by itself define or impose any limitations or prerequisites concerning the accounting principles and practices used in preparing the statements; however, the defendant has issued a series of statements known as Accounting Series Releases which are incorporated into Rule SX by its rule or by -- into Regulation SX by its Rule 1-101(a).

The defendant SEC, as we all know, is an agency of the United States established by the Congress in 1934. It has statutory power to administer and enforce the various federal securities laws. It has been empowered by the Congress to make rules and regulations implementing and enforcing the laws which it administers, including rules and regulations concerning accounting.

The plaintiff seeks a preliminary injunction enjoining and restraining the defendant from enforcing or applying two issuances known as ASR-150 and ASR-177, the content and details of which will be touched upon momentarily.

The standards for the issuance of a preliminary injunction are well-known, and the parties and their counsel have addressed them.

The first, in view of the immediacy of the relief which is given, is that the plaintiff demonstrate a likeli-

hood of success on the merits. The second is that the plaintiff demonstrate that it will suffer irreparable harm if the preliminary relief is not granted. The third is that there be a showing that the defendant will not suffer irreparable harm as a consequence of any preliminary relief. And the fourth is that the issuance of the preliminary relief will not be adverse to the public interest.

The first item in controversy is defendant's ASR-150, which was issued on December the 20th, 1973. The defendant concedes that the rule-making provisions of the Administrative Procedure Act and the Commission were not followed prior to the issuance of ASR-150 because as defendant asserts, it is not a rule; rather, it is concerned with defendant's recognition of certain accounting principles enjoying widespread recognition in the accounting profession.

Some history, brief history, is warranted in appraising the significance, purpose and impact of ASR-150.

On April 25, 1938, prior to the enactment of the Administrative Procedure Act, the defendant issued its ASR-4, which provided in part as follows: "In cases where financial statements filed with this Commission pursuant to its rules and regulations under the Securities Act of 1933 or the Securities Exchange Act of 1934 are prepared in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be pre-

sumed to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material.

"In cases where there is a difference of opinion between the Commission and the registrant as to the proper principles of accounting to be followed, disclosure will be accepted in lieu of correction of the financial statements themselves only if the points involved are such that there is substantial authoritative support for the practices followed by the registrant and the position of the Commission has not previously been expressed in rules, regulations or other official releases of the Commission including the published opinions of its chief accountant."

The meaning of the expression "substantial authoritative support" contained in ASR-4 was left, as I perceive the record and briefs, to a case-by-case determination. While the Committee on Accounting Procedures of the American Institute of Certified Public Accountants issued research bulletins in respect to accounting principles from time to time, and later the Accounting Principles Board of the Institute issued opinions in regard to those principles, there was, as we see it, no single source of authoritative standards. Although the defendant Commission has and has had the power to promulgate its own accounting standards, it has elected historically in deference to and in coopera-

tion with the accounting profession not to do so.

In 1973, conditions within the accounting profession changed. The American Institute of Certified Public Accountants designated the Financial Accounting Standards Board of the Financial Accounting Foundation as the body to establish authoritative accounting principles pursuant to Rule 203 of the American Institute of Certified Public Accountants, which rule was in turn made obligatory upon the members of the AICPA.

It was thereafter that ASR-150 was issued by the SEC. After summarizing the content and import of ASR-4, ASR-150 provides in that respect, as I perceive it, deemed offensive by the plaintiff, as follows: "For the purposes of this policy" -- that being the policy previously articulated in ASR-4 -- "For the purposes of this policy, principles, standards and practices promulgated by the FASB in its statements and interpretations will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered to have no such support.

By ASR-150, the defendant SEC has said no more than that it will henceforth, in making its long-standing inquiry into whether a financial statement has been prepared in accord with accepted accounting principles, apply and look to the substantial authoritative support provided by the FASB. Those principles will be, those principles approved

by the FASB, will be considered as having substantial authoritative support, while those contrary to the principles approved by the FASB will not be.

In taking this position, in my judgment, the SEC has done no more than state the obvious. Now that an authoritative profession-accepted collection of accounting principles exists, it will look to them first in making its own judgment on the question of authoritative support.

On the other hand, a principle contrary to the FASB standards will be considered without support. No mention is made for a principle which is neither embraced by nor rejected by the FASB.

ASR-150 emerges, then, as a method by which the SEC will evaluate accounting principles. It does not ordain the result of that evaluation. It does not prescribe per se approval to or rejection of any accounting principle. It merely acknowledges a fact, the existence of an authoritative body of principles, and says that it will credit those principles.

It is not a conditional imperative, which is the characteristic of a substantive rule.

Nor is ASR-150 rendered invalid by the hyperbole that the SEC has delegated impermissibly its rule-making authority to FASB. True, ASR-150 will encompass not only past, but future accounting principles approved by the FASB, but those prospective principles

will have no greater force than the present ones do. The SEC will consider them authoritative, which they clearly are and will be, but ASR-150 does not even suggest that the SEC will abdicate its ultimate responsibility to judge the propriety of the accounting principles employed by a registrant.

Accordingly, as to ASR-150, we have concluded preliminarily that the plaintiff has failed to show the requisite likelihood of success on the merits, so as to entitle it to preliminary relief.

Return to ASR-177, which concededly adopted a rule amending Instruction H(f) of Form 10-Q, which is a quarterly financial report which must be filed with the SEC by certain registrants. Plaintiff concedes that the Administrative Procedure Act was followed by the SEC through the comment stage in promulgating H(f). Here plaintiff's complaint is in essence that the SEC arbitrarily rejected the comments which we are told were overwhelmingly adverse to H(f), and alternatively, that H(f) is arbitrary and capricious because it may prove impossible for an accountant's registrant client to comply with it.

As for the first contention, rejection of the comments, our understanding is that the adverse comments originated with the accounting profession. The totality of the record here does not suggest that the SEC is deaf to the

opinions of the accounting profession. Indeed, the history of ASR-150 and its forerunner, ASR-4, show precisely the contrary; furthermore, it is not unusual for a group which will be affected by a change in regulations to be opposed to it. The status quo is comfortable, but often not adequate.

It is here on a motion for a preliminary relief that courts should give special credence to the expertise of commissions such as the defendant. True, the defendant's decision is subject to review here, but the review should be deliberate and not hasty. Indeed, it is only in the most extraordinary circumstances that the public interest is served by a court peremptorily preempting the legislative judgment of a commission such as the SEC which is charged with protecting the public interest in a given specialized area. No showing of extraordinary circumstances or patent abuse of discretion has been shown here.

Insofar as the impossibility of compliance is concerned, we think that plaintiff and its supporting amicus colleagues read H(f) too severely. It provides this: When a business enterprise changes an accounting principle or practice previously followed, the first Form 10-Q report filed subsequent thereto must include as an exhibit a letter from its independent accountants indicating whether or not the change is to an alternate principle which in his judgment is preferable under the circumstances. No letter described

in "B" will be required if the change is made in response to a future standard adopted by the FASB which requires the change.

No substantial gloss has been placed upon the phrase "Under the circumstances". But our reading of it at this preliminary stage is that the totality of Amendment H(f) says no more than that the accountant should state why in the particular situation, where a change in practice has been adopted, why that change has been effected. Why "under the circumstances" is the new method preferable to the old? We just do not perceive the impossibility of responding to that inquiry. Some reason must exist for the change. Plaintiff's clients are obliged to state the reasons through their professional spokesmen, the accountants.

Accordingly, in our judgment, plaintiff has again failed to show that degree of likelihood of success on the merits as to warrant a granting of preliminary relief.

There is in the case another question which is traditionally a threshold inquiry: plaintiff's standing to complain. We have doubts on that score, but because the resolution of that issue adverse to the plaintiff would result in the termination of the action, we decline in this hurried setting to resolve it. That can await more mature deliberations even while this order is reviewed by a reviewing court, should that be the course the plaintiff takes.

We turn briefly, however, to the questions of irreparable harm. Insofar as plaintiff is concerned, we see no harm flowing to it from the SEC's application of the evaluative standards articulated in ASR-150. Plaintiff has pointed out none which are offensive to it. We must assume on this record that plaintiff abides the teachings of the FASB in its day-by-day practice.

On the other hand, a preliminary injunction could work irreparable harm to the SEC in the discharge of its duties. What would be the consequence of such an injunction? Would the SEC be precluded from giving any credence to the FASB standards? And what credence should the balance of the accounting profession give those standards?

As for ASR-177, that is H(f), we are constrained to say that despite the stature of those who protest it, we perceive it as quite innocuous. All it asks is that a registrant, a registrant's accountant state why the registrant has changed from one accepted method or principle of accounting to another. There must be a reason for the change. What harm can flow from articulating it.

But, on the other hand, to deny the SEC this information, even though we are told it has not required it in the past, could irreparably impede its discharge of its regulatory obligations. Indeed we must say that we are surprised to learn in this proceeding that the information now required

by H(f) has not been required in the past.

For the foregoing reasons, the plaintiff's motion for a preliminary injunction will be denied.

What we have said will stand as our findings of fact and conclusions of law under Rule 52(a) and 65(d) of the Federal Rules of Civil Procedure.

If the parties wish a review of the order, the reporter will transcribe my remarks and I will sign them as written findings and conclusions.

Now, do we have any scheduling problems ahead of us? Everybody going to get their answers in, motions in and so forth?

MR..BOAND: Your Honor, would your Honor certify this under 1292(b)?

THE COURT: I don't think we need to certify it. The denial of a preliminary injunction is an appealable order, and I can't recall the time in which it can be appealed, but I think it's 30 days, the same as any other appealable order. Certainly you've got 10 days within which to appeal it as a matter of right by a notice of appeal.

All right. All we need this morning then, Rita, is a minute order that reads, "For the reasons stated in open court, plaintiff's motion for preliminary injunction is denied," and, Barbara, you may have some customers shortly.

And because we are five minutes early, Wayne, maybe

we better go off.

WHICH WERE ALL THE PROCEEDINGS HAD IN THE ABOVE-ENTITLED MATTER ON THE DAY AND DATE AFORESAID

Judge, United States District Court,
Northern District of Illinois

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ARTHUR ANDERSEN & COMPANY, Plaintiff,	)	
vs.	)	No. 76 C 2832
SECURITIES & EXCHANGE COMMISSION, Defendant.	)	

C E R T I F I C A T E

I hereby certify that the above and foregoing transcript, Pages 1 to 14, inclusive, is a full, true and accurate transcript of the original shorthand notes taken upon the hearing of the above-entitled cause on Friday, September 3, 1976.

RICHARD H. DAGUIGIAN,
Official Court Reporter,
United States District Court,
Northern District of Illinois.

APPENDIX J
COST ACCOUNTING STANDARDS BOARD, GENERAL ACCOUNTING OFFICE AND INTERNAL REVENUE SERVICE

ABRAHAM RIBICOFF, CONN., CHAIRMAN

JOHN L. MC CLELLAN, ARK.
HENRY M. JACKSON, WASH.
EDMUND S. MUSKIE, MAINE
LEE METCALF, MONT.
JAMES B. ALLEN, ALA.
LAWTON CHILES, FLA.
SAM NUNN, GA.
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CHARLES H. PERCY, ILL.
JACOB K. JAVITS, N.Y.
WILLIAM V. ROTH, JR., DEL.
BILL BROCK, TENN.
LOWELL P. WEICKER, JR., CONN.

RICHARD A. WEGMAN
CHIEF COUNSEL AND STAFF DIRECTOR

SUBCOMMITTEE:
LEE METCALF, MONT., CHAIRMAN

JOHN L. MC CLELLAN, ARK.
EDMUND S. MUSKIE, MAINE
SAM NUNN, GA.
JOHN GLENN, OHIO

BILL BROCK, TENN.
CHARLES H. PERCY, ILL.
LOWELL P. WEICKER, JR., CONN.

VIC REINEMER, STAFF DIRECTOR
E. WINSLOW TURNER, CHIEF COUNSEL
161 RUSSELL BUILDING

(202) 224-1474

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. [illegible], 94TH CONGRESS)
WASHINGTON, D.C. 20510

1 March 1976

The Honorable Elmer B. Staats
Chairman
Cost Accounting Standards Board
441 G Street N.W.
Washington, D.C. 20548

Dear Chairman Staats:

This subcommittee is reviewing the accounting responsibilities of certain Federal agencies. We are especially interested in the setting of accounting rules, principles, or standards which must be followed by businesses or accounting firms as a result of determinations made by Federal agencies.

Please furnish us with a concise description and summary of your agency's accounting responsibilities and tho legal authority from which the accounting responsibilities are derived. A brief description of your agency's authority to compel compliance, punish non-compliance, and gain access to accounting-related records, procedures, or other necessary information should also be included.

Questions, if any, regarding this request should be directed to subcommittee counsel, Jack Chesson, at 224-1474.

Very truly yours,

ORIGINAL SIGNED BY
LEE METCALF

67-159 O - 77 - 100

COST ACCOUNTING STANDARDS BOARD
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WASHINGTON, D.C. 20548
Telephone: (202) ~~386-6213~~ 275-6111

ELMER B. STAATS
Chairman
HERMAN W. BEVIS
ROBERT K. MAUTZ
TERENCE E. McCLARY
JOHN M. WALKER

ARTHUR SCHOENHAUT
Executive Secretary

March 15, 1976

The Honorable Lee Metcalf, Chairman
Subcommittee on Reports, Accounting,
and Management
Committee on Government Operations
United States Senate

Dear Mr. Chairman:

Following is the information requested in your letter of March 1, 1976. The Cost Accounting Standards Board was established by Public Law 91-379, Act of August 15, 1970, 84 Stat. 796. That law, among other things, added section 719 to the Defense Production Act of 1950, as amended (50 U.S.C. App. 2168). The Board's authority derives from that law, and quotations of the Board's accounting responsibilities which follow are from portions of that law.

The Board is required from time to time "to promulgate cost-accounting standards designed to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts." (Sec. 719(g)) Standards so promulgated must be used by all relevant Federal agencies and by defense contractors and subcontractors in estimating, accumulating and reporting costs in connection with the pricing, administration and settlement of the negotiated contracts subject to the Board's jurisdiction. (Ibid.) The Board has, under this authority, promulgated to date eleven Cost Accounting Standards (4 C.F.R., Parts 401-409, 411, and 412).

Additionally, the Board is authorized to issue rules and regulations for the implementation of Cost Accounting Standards. (Sec. 719(h)(1)) Such regulations must require defense contractors and subcontractors as a condition of contracting, "to disclose in writing their cost-accounting principles, including methods of distinguishing direct costs from indirect costs and the basis used for allocating indirect costs." (Ibid.) Under this authority, the Board has issued a regulation on Basic Requirements, which promulgates a Disclosure Statement to be submitted by certain defense contractors and subcontractors (4 C.F.R., Part 351); and a regulation on Contract Coverage (4 C.F.R., Part 331), which promulgates a Cost Accounting Standards Clause for use in appropriate defense contracts.

The Department of Defense reports that it includes the Cost Accounting Standards Clause in about $16 billion of DOD contracts annually. Additionally, defense contracts entered into by the National Aeronautics and Space Administration and the Energy Research and Development Administration account for approximately $4 billion annually. Thus, the Board's requirements are included in approximately $20 billion worth of defense contracts annually.

You may be interested in knowing that although Section 719 makes Cost Accounting Standards and the Board's rules and regulations applicable to defense contractors and subcontractors only, the General Services Administration in its Federal Procurement Regulations has, as a matter of policy, extended the Board's requirements to the major negotiated contracts of civilian agencies of the Government as well. (41 C.F.R. 1-3.1201) We do not have any specific information on the dollar volume of these contracts.

The Board has no specific statutory authority to compel compliance or to punish noncompliance with its Standards, rules and regulations. In this connection, however, Sec. 719(h)(1) does establish statutory requirements to be followed in the event of certain contractor or subcontractor noncompliances.

Under Sec. 719(j), any authorized representatives of the Board, as well as of the head of the agency concerned and of the Comptroller General of the United States, have the right, for the purpose of determining whether a defense contractor or subcontractor has complied with Cost Accounting Standards and has consistently followed his disclosed cost accounting practices, "to examine and make copies of any documents, papers, or records of such contractor or subcontractor relating to compliance with such cost-accounting standards and principles." (Sec. 719(j)) This statutory provision for access to records has been prescribed as part of the Cost Accounting Standards Clause promulgated by the Board. (4 C.F.R. 331.50(c))

The Board has also by regulation (4 C.F.R. 351.70) required submission to it of copies of Disclosure Statements which a Federal contracting agency has determined to be adequate. As of December 31, 1975, the Board has received 1,328 copies of Disclosure Statements from 165 companies pursuant to this requirement.

We will be happy to discuss with you or with Subcommittee staff members any further matters concerning the Cost Accounting Standards Board which may be of interest to you.

Sincerely yours,

Chairman

COST ACCOUNTING STANDARDS BOARD
441 G STREET, N.W.
WASHINGTON, D.C. 20548
Telephone: (202) ~~386-6215~~ 275-6111

June 22, 1976

Mr. Jack Chesson
Senate Subcommittee on Reports,
Accounting, and Management
Room 161
Old Senate Office Building
Washington, D.C. 20510

Dear Mr. Chesson:

In accordance with your telephone request of yesterday, enclosed are lists of the members of committees of professional accounting associations which have assisted the Cost Accounting Standards Board in its work. These committees meet with staff and Members of the Board at times to discuss Board proposals, and they furnish written comments which generally contain constructive criticism of Board proposals or suggestions for viable alternatives to what is being proposed by the Board. The professional accounting associations represented by these committees are the:

American Accounting Association
American Institute of Certified Public Accountants
Association of Government Accountants
Financial Executives Institute
National Association of Accountants

There is also enclosed a list of the members of the Interagency Advisory Committee to the Cost Accounting Standards Board. The Board encouraged the establishment of this committee in 1972 to assist in the implementation of promulgated Standards, rules and regulations. The committee is composed of controller and procurement representatives of the Office of Federal Procurement Policy (OFPP), Department of Defense, Energy Research and Development Administration, General Services Administration, National Aeronautics and Space Administration, Department of Health, Education and Welfare, and the Department of Transportation. The committee is chaired by the Administrator of the OFPP.

Finally, as requested, there are enclosed copies of letters dated April 13, 1976, to the Chairman of the Board and the President of the American Institute of Certified Public Accountants informing them that the Cost Accounting Standards Board would present its public service award to the AICPA on May 17, 1976.

Sincerely yours,

Arthur Schoenhaut

Arthur Schoenhaut
Executive Secretary

Enclosures
(As stated)

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National Association of Accountants

Management Accounting Practices Committee

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C ACCOUNTING STANDARDS BOARD
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WASHINGTON, D.C. 20548
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APR 1 3 1976

Mr. Ivan O. Bull
Chairman of the Board
American Institute of Certified
Public Accountants
1211 Avenue of the Americas
New York, New York 10036

Dear Mr. Bull:

The Cost Accounting Standards Board is pleased to inform you that it will present its Public Service Award to the American Institute of Certified Public Accountants (AICPA) on Morday, May 17, 1976. The Award is being made in recognition of the contribution by the AICPA in assuring active participation by professional accountants in the Board's research in the field of cost accounting.

The Cost Accounting Standards Board Committee of the AICPA chaired in the past by George R. Catlett and Kenneth P. Johnson and more recently by Donald J. Hayes has provided the Board and its Staff with constructive assistance and advice during many phases of the Board's research into possible Cost Accounting Standards. The Committee members have shown a willingness to take the time to meet with Board representatives on numerous occasions to discuss various issues and proposals, and the Committee's written comments to the Board have been timely, objective, penetrating and cogent. This cooperative attitude has contributed significantly to the professional quality of the Board's promulgated Standards.

The Award will be presented at 12 noon in Room 7000 of the General Accounting Office Building, 441 G Street, N.W., Washington, D.C.

The Board cordially invites you to the presentation of the Award and hopes you will also accept its invitation for luncheon immediately afterwards.

Sincerely yours,

Chairman

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 383, 94TH CONGRESS)
WASHINGTON, D.C. 20510

5 December 1975

The Honorable Elmer B. Staats
Chairman
Cost Accounting Standards Board
441 G Street N.W.
Washington, D.C. 20548

Re: Historical Depreciation
Costs for Inflation (4CFR Part 413)

Dear Chairman Staats:

I strongly oppose this proposed rule to adjust depreciation charges for inflation on all future contracts subject to Cost Accounting Standards Board accounting rules. Not only would the proposed rule apply to defense contracts, but also to most non-defense contracts since the General Services Administration has decided to follow CASB accounting rules on contracts subject to its jurisdiction.

Adoption of this proposal would unjustly enrich government contractors at the expense of beleaguered taxpayers -- all under the guise of a simple change in accounting rules. As chairman of the subcommittee charged with ensuring fair and responsive accounting practices by Federal agencies, I strongly object to this hidden raid on the Treasury.

The CASB has proposed to recognize one aspect of the "inflation accounting" now in vogue with academic accountants. Significantly, the CASB proposal would permit contractors to charge the Federal government for unrealized inflation-related "expenses" without recognizing comparable unrealized gains.

Depreciation is a non-cash expense allowed so that contractors can recoup the capital invested over the useful life of an asset. This charge permitting capital recovery is in addition to the profit allowed the contractor for the use of his capital. Thus under the present system, a contractor both earns a profit and recovers his capital investment.

Apparently, the CASB believes that is not enough. The proposed rule would permit a contractor to increase the "cost" of an asset by the amount of inflation which has occurred since its purchase as measured by the GNP price deflator. Depreciation would then be computed on the inflated asset value, leading to a larger depreciation charge to be passed on to the Treasury.

The result of computing depreciation on ficticious "costs" which the contractor has never incurred are twofold. First, the contractor is permitted to recover through depreciation charges more capital than he has actually invested over the life of an asset.

Secondly, increased depreciation expenses mean that less money is left to fall into the profit category, which gives the illusion of lower profits on government contracts.

While the CASB proposal will allow contractors to show lower profits on Federal contracts and perhaps ask for even more money, it will not serve the public interest in having fair accounting standards which only permit a contractor to recover his actual, out-of-pocket costs.

The explanatory text of the proposed rule demonstrates a misunderstanding of inflation adjustments already built into government contracts, and incorrectly equates actual increased dollar expenditures for materials and labor with unrealized loss of value for dollars invested in capital assets. However, the fact that the CASB now proposes to enter the fantasyland of compensating contractors for "costs" not related to actual cash expenditures is candidly admitted:

> "When contract prices are based on costs, the contract parties have typically assumed a definition of "cost" which would exclude amounts of the type under consideration in the proposed Standard. This proposal represents a break from the established requirement that "cost" be incurred in the sense of representing a cash outlay. The proposed Standard would measure a contract cost which is not such an expenditure."

I am amazed that the CASB would embark on such a radical departure from accepted cost accounting standards without specific direction from the Congress, especially when the potential drain on the Treasury is so great. Inflation erodes the dollars of everyone, and government contractors are not a special class who deserve to have their purchasing power guaranteed. I am quite sure that contractors take inflation into account when submitting cost estimates to win a Federal contract.

There are several other reasons to reject this proposal:

1) The proposed rule incorrectly assumes each asset will be replaced. If an asset is replaced and its cost is more than the amount recovered through depreciation, the proper way to finance the excess is to raise additional capital at rates which will cover inflationary expectations at that time. Many assets are never replaced at all. Unreplaced assets or those replaced at lower cost would result in a windfall to contractors under the proposed rule.

2) The impact of inflation on invested capital is already realized in setting interest rates or the fair level of profit. An interest rate is comprised of two parts - a true rate of interest of about 2 or 3 per cent to cover the time value of borrowed money, and an inflation adjustment comprising the rest to cover the lender's expectation of inflationary impact on the value of his capital over the term of the loan. That is why interest rates rise and fall in response to inflationary pressures. Determination of a proper interest rate is the responsibility of free money markets, not the CASB.

3) The proposed rule would apply the broadest measure of inflation - the GNP price deflator - as the adjustment factor, without regard for the actual inflationary conditions affecting each asset. There is no generally accepted method for determining inflated property values. Property valuation is a complex legal and economic process that renders speculatave results even where intensive study is given to specific property. Valuation of utility properties is the one area where replacement costs were given wide application, and the result is that nearly every regulatory body has abandoned the replacement value concept in favor of original costs. The broad adjustment factor proposed by the CASB is the most speculative possible, and is totally arbitrary.

4) Inflation increases the value of existing assets as well as new assets. Much of the property charged to the Federal government in theoretical depreciation may actually have increased in value beyond original cost. Does the CASB propose to have contractors donate such unrealizedcgains to the Treasury?

5) Adjusting all financial items for inflation yields purchasing gains as well as losses. Net debtors repay lenders with dollars of decreased value - a gain for them which must be realized in income. (A fine article on this subject and business opposition to inflation accounting appeared in the 12 November, 1975 issue of the *Wall Street Journal* on page 42.) It disturbs me that the CASB is proposing speculative cost adjustments where contractor expenses are involved without also proposing corresponding adjustments for speculative gains that might benefit the Federal government. The world of fantasy and speculation cannot be entered selectively.

The concept of cost accounting has always sought to establish actual; realized costs so that expenditures may be reimbursed. Depreciation has allowed contractors to recover actually invested capital. The theory of depreciation was never meant to guarantee the replacement of assets since that value cannot be accurately determined in advance.

Accountants have never accepted that assets will or ought to be replaced until real expenditures are entered on the books.

It is time for the CASB to reaffirm its own admission that "cost" has always meant a cash outlay. I see no indication that government contractors need special aid, or that the Congress intends that they have it. This proposed rule should be terminated immediately.

Very truly yours,

Original signed by
Lee Metcalf

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United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

1 March 1976

The Honorable Elmer Staats
Comptroller General
General Accounting Office
Washington, D.C. 20548

Dear General Staats:

This subcommittee is reviewing the accounting responsibilities of certain Federal agencies. We are especially interested in the setting of accounting rules, principles, or standards which must be followed by businesses or accounting firms as a result of determinations made by Federal agencies.

Please furnish us with a concise description and summary of your agency's accounting responsibilities and the legal authority from which the accounting responsibilities are derived. A brief description of your agency's authority to compel compliance, punish non-compliance, and gain access to accounting-related records, procedures, or other necessary information should also be included.

Questions, if any, regarding this request should be directed to subcommittee counsel, Jack Chesson, at 224-1474.

Very truly yours,

ORIGINAL SIGNED BY
LEE METCALF

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-115390 March 31, 1976

The Honorable Lee Metcalf
Chairman, Subcommittee on Reports,
Accounting, and Management
Committee on Government Operations
United States Senate

Dear Mr. Chairman:

Our responsibility for prescribing accounting principles and standards about which you inquired in your letter of March 1, 1976, pertains only to executive agencies of the Federal Government. The "Accounting and Auditing Act of 1950 (31 U.S.C. 66) provides that:

"The Comptroller General of the United States * * * shall prescribe the principles, standards, and related requirements for accounting to be observed by each executive agency * * *.

"The General Accounting Office shall cooperate with executive agencies in the development of their accounting systems * * *.

"Such accounting systems shall be approved by the Comptroller General * * *."

This Office has no authority or responsibility to set accounting rules, principles, or standards which must be followed by business or accounting firms. Of course, if an accounting firm or other contractor designs an accounting system for a Federal agency, it is required indirectly to follow our standards since the system ultimately developed is required to meet our standards.

We have no authority to compel compliance or punish noncompliance with our requirements by executive agencies. We have no problems gaining access to accounting related records, procedures, or other necessary information when we are working with agencies which have requested our approval of their accounting systems.

Should your staff have questions concerning our area of accounting responsibilities, they may call Dick Maycock at 275-5071.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

1 March 1976

Mr. Donald Alexander
Commissionor
Internal Revenue Service
Department of the Treasury
Washington, D.C. 20224

Dear Commissioner Alexander:

This subcommittee is reviewing the accounting responsibilities of certain Federal agencies. We are especially interested in the setting of accounting rules, principles, or standards which must be followed by businesses or accounting firms as a result of determinations made by Federal agencies.

Please furnish us with a concise description and summary of your agency's accounting responsibilities and the legal authority from which the accounting responsibilities are derived. A brief description of your agency's authority to compel compliance, punish non-compliance, and gain access to accounting-related records, procedures, or other necessary information should also be included.

Questions, if any, regarding this request should be directed to subcommittee counsel, Jack Chesson, at 224-1474.

Very truly yours,

ORIGINAL SIGNED
LEE METCALF

Department of the Treasury / **Internal Revenue Service** / Washington, D.C. 20224

Commissioner

APR 22 1976

Honorable Lee Metcalf
United States Senate
Washington, D. C. 20510

Dear Senator Metcalf:

This is in response to your letter of March 1, 1976, in which you requested the accounting rules, principles, or standards that must be followed by businesses or accounting firms as a result of determinations made by the Internal Revenue Service.

In a telephone conversation with Mr. Jack Chesson, your Subcommittee Counsel, on March 23, 1976, it was indicated that the Subcommittee did not want a detailed list of every accounting requirement. Accordingly, this letter is not intended to be all inclusive, but rather is intended to provide a concise description and summary of the Internal Revenue Service's accounting responsibilities, including the legal authority from which the accounting responsibilities are derived. Also included is a brief description of our power to compel compliance and gain access to accounting records.

The primary function of the Service is to administer the Internal Revenue Code of 1954 (hereinafter referred to as the Code). The statutory authority under which the Service administers and enforces the Code is contained in Chapters 61-80 of Subtitle F of the Code. The authority of the Service to require any person subject to tax under Subtitle A of the Code to keep permanent books of account or records is set forth in section 6001. This section provides broad powers to issue regulations for the maintenance of such records as are deemed necessary by the Service.

Generally, the authority to prescribe accounting rules, standards, and principles is to ensure that taxable income is clearly reflected. Each taxpayer is required to make a return of his taxable income for each taxable year and must maintain such accounting records as will enable him to file a correct return. Under the authority of section 441 of the Code, taxable income is computed on the basis of an annual accounting period. Under this concept, taxes are assessed on the basis of annual returns showing the net result of all of the taxpayer's transactions during a single accounting period.

Section 446 of the Code provides the general rule that taxable income shall be computed on the basis of which the taxpayer regularly computes his income in keeping his books. If no method of accounting has been regularly used by the taxpayer or if the method does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income. The regulations under section 446 provide that no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income, and the Commissioner has broad discretion in rejecting or approving an accounting method under section 446 of the Code.

While no particular method of accounting is prescribed for all taxpayers, once a taxpayer adopts a method of accounting, he may not change his method of accounting without the prior consent of the Commissioner. If a taxpayer's method of accounting is changed, section 481 of the Code requires, generally, that adjustments are made to prevent duplication or omission of income under the new method of accounting.

In addition to the general accounting provisions required under section 446 of the Code, there are numerous other provisions in the Code and/or regulations, either elective or mandatory, that provide specific accounting rules, to be used in computing taxable income. For example, section 471 permits the Service to determine when the use of inventories are necessary in order to clearly reflect taxable income. Section 472 allows taxpayers to elect the last-in, first-out (LIFO) method of valuing inventories. However, if a taxpayer fails to follow this method in his financial reports, he will lose his election to employ such method.

You may find our enclosed publication number 538, Tax Information on Accounting Periods and Methods, useful as a further background aid in understanding the authority of the Service with respect to accounting methods.

To enable the Service to compel compliance with the Code, sections 7602-7605 and the regulations thereunder enable the Service to examine returns. These sections provide the authority to ascertain the accuracy of a return or make a return where none has been made, and to examine

any books, papers, records or other data bearing on matters required to be included in the return. And, sections 6211-6215 of the Code provide that the Service may issue a Notice of Deficiency and assess such deficiencies determined upon the examination of tax returns by District Directors.

Sections 6651-6659 of the Code provide the Service authority to assess additional amounts as tax for noncompliance such as failure to file a tax return, failure to pay tax, etc. Sections 6671-6693 set forth assessable penalties for such instances of noncompliance as failure to collect and pay over tax or attempt to defeat or evade tax and other types of noncompliance. Included also, are the rules for the application of assessable penalties. Sections 7201 and 7202 provide criminal penalties for willful attempt to evade or defeat tax and willful failure to collect and pay over tax.

We hope the above information is helpful to you, and if we can be of any further assistance, please do not hesitate to contact us.

With kind regards,

Sincerely,

Donald C Alexander

Commissioner

Enclosure

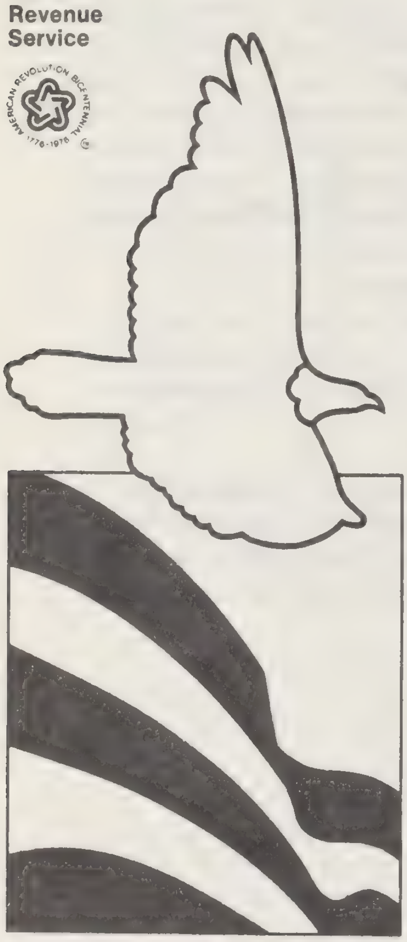
Publication 538

Tax Information on Accounting Periods and Methods

1976 Edition

For use in preparing 1975 Returns

Department of the Treasury **Internal Revenue Service**



Introduction

Taxable income must be computed on the basis of a fixed accounting period and in accordance with a set of rules to determine the time and manner of reporting income and deductions.

A method of accounting is that set of rules under which you determine when and how to record income and expenses in your books, and how to prepare your profit and loss statement, for your accounting period.

You must be consistent and compute taxable income in accordance with the method of accounting regularly used in keeping your books, if that method clearly reflects your income. Any method of accounting that reflects the consistent application of generally accepted accounting principles in accordance with accepted conditions or practices in your trade or business will ordinarily be regarded as clearly reflecting income. A method of accounting will clearly reflect income only if all items of gross income and all deductions are treated consistently from year to year.

Specific deviations are permitted or required, however, in the treatment of certain items, such as installment sales, long-term contracts, research and experimental expenditures, depreciation, etc.

Accounting Methods

No particular method of accounting is prescribed for all taxpayers. Each must adopt a system that is best suited to his or her purpose and that will clearly reflect income. This necessitates your maintaining, in addition to your permanent books of account, such other records and data as may be required to support the entries on your books and tax returns.

Among the essentials that must be considered in maintaining your records are the following:

1) Inventories are required in all cases where the production, purchase, or sale of merchandise is an income-producing factor;

2) Expenditures must be classified properly between capital and expense; and

3) Expenditures (other than for ordinary repairs) made to restore property or prolong the useful life of a depreciable asset must be charged to the property account or appropriate reserve and not to current expenses.

If you do not employ a method of accounting or if the method you use does not clearly reflect income, your income will be computed according to a method that, in the opinion of the Internal Revenue Service, clearly reflects income.

Permissible methods. Subject to the above rules, a taxpayer may compute taxable income under any of the following methods of accounting:

1) ***Cash*** receipts and disbursements method;

2) ***Accrual*** method;

3) ***Special*** methods such as, for example, those for installment sales and long-term contracts; and

4) ***Any other method*** that clearly reflects income, including combinations of the above methods.

The Cash Receipts and Disbursements Method

Income. The cash method requires you to include in gross income all items of income you ***actually or constructively*** received during the year. Property and services received must be included at their fair market value.

Constructive receipt of income occurs when an amount is credited to your account or set apart for you (even though it is not actually in your possession) so that it is subject to your control and you may draw upon it at any time. To constitute receipt the amount must be available to you without any substantial limitation or restriction as to the time or manner of payment.

Examples.

1) Interest credited to your bank account in December 1975 must be included in your gross income for 1975 and not for 1976 when withdrawn or entered in the passbook.

2) Interest coupons matured and payable in 1975, but not cashed until 1976, must be included in income for 1975. This matured interest is included in gross income even though the coupons are later exchanged for other property instead of being cashed.

Property cannot be held from one tax year to another to avoid payment of tax on the income since such income is properly included in the year in which the checks or other property are set aside for you and are subject to your demand.

Expenses. Generally, expenses must be deducted in the tax year in which they are actually paid. However, special treatment is provided for expenditures attributable to more than 1 year.

Expenses paid in advance are deductible only in the year in which they apply. Thus, the payment last year for a 3-year insurance policy must be prorated over the period the insurance is in effect.

Example. If you use the calendar year as your tax year and pay $300 for a policy effective on July 1, 1975, for a 3-year period, your deductions are $50 for 1975, $100 each for 1976 and 1977, and $50 for 1978.

Supplies and materials on hand at the end of the year that do not physically become part of goods manufactured and intended for

sale are treated as deferred expenses and are deductible in the year in which they are placed into use.

Incidental supplies and materials, however, for which no record of consumption is kept and which do not physically become part of goods manufactured and intended for sale, may be deducted in the year purchased, provided taxable income is clearly reflected.

Accrual Method

Income. Under this method, all items of income are included in gross income when earned, even though payment may be received in another tax year. All events fixing the right to receive the income must have occurred and you must be able to determine the amount with reasonable accuracy.

Example. Mr. Smith, a calendar-year taxpayer, sold a radio on November 28, 1975. He billed the customer 3 days later but did not receive payment until February 1976. He would include the amount of the sale in his income for 1975 because the income was earned in that year.

Advance payments for services to be performed by the end of the next succeeding tax year under an agreement (written or otherwise), if you use an accrual method of accounting, can be deferred from income until earned through performance of services, but not beyond the year following the year of receipt.

Deferral is permitted for advance payments you receive under service agreements (including agreements providing for incidental replacement of parts or materials) that relate to property that in the normal course of business you offer to sell, lease, build, install, or construct without service agreements.

This method may not be used for amounts received under guaranty or warranty or for prepaid rent or prepaid interest. As used here "rent" does not include payments for use or occupancy of rooms or other space where significant services are also rendered to the occupant, such as payments for use and occupancy of rooms and other quarters in hotels, boarding houses, tourist homes, motor courts, motels or apartment houses furnishing hotel services.

Generally, deferral is not permitted for advance payments if, under the terms of the agreement:

1) Any portion of the services is to be performed by you after the end of the tax year immediately succeeding the year of receipt; or

2) Any portion of the services is to be performed by you at any unspecified future date which may be after the end of the tax year immediately succeeding the year of receipt.

Any advance payment that you include in gross receipts in the tax year you receive the payment must be no less than the amount of such payment included as gross receipts in gross income for the purposes of your books and records and all your reports (including consolidated financial statements) to shareholders, partners, other proprietors or beneficiaries and for credit purposes.

If you desire to adopt the deferral of income method described above, you must secure the prior consent of the Internal Revenue Service.

In each example below the taxpayer uses the calendar year and the accrual method of accounting.

Example 1. You are in the business of manufacturing, selling, and servicing television sets. Payments you received in 1975 for television sets sold with 1-year service contracts must be included in income for that year. You may not defer inclusion of these payments in income since the property to be serviced is sold by you, unless you offer the television sets for sale without contingent service contracts.

Example 2. You are in the television repair business. In 1975, you receive payments for 1-year contracts under which you agree to repair or replace parts that fail to function properly in television sets that were sold by an unrelated party. You may include the payments in gross income as they are earned through the performance of services.

If for any reason a portion of the services is not performed by the end of the next succeeding tax year (1976), the amount allocable to the unperformed services must be included in gross income for that year (1976) regardless of when the services are performed.

Example 3. You are the owner of a dance studio. On November 1, 1975, you receive payment for a 1-year contract commencing on that date and providing for 48 individual, 1 hour lessons. You provide eight lessons in 1975. Under the deferral method you must include one-sixth of the payment in income for 1975, and five-sixths of the payment in 1976 even if you are unable to give all the lessons by the end of 1976.

Advance payments for future sales of goods, received by a taxpayer using the accrual method of accounting, may be included in his income either in the tax year received or when properly accruable under his method of accounting. If such advance payments are deferred in accordance with the taxpayer's method of accounting, they may be deferred until the second tax year following the tax year in which he has received substantial advance payments and in which he has available goods of substantially similar kind and in sufficient quantity to satisfy the agreement. For this second succeeding tax year, he must include in income all advance payments received under the agreement and must deduct actual or estimated inventoriable costs of goods necessary to satisfy the agreement.

Substantial advance payments are considered received by the end of a tax year if total advance payments under an agreement for a future sale received during the current and preceding tax years equal or exceed total costs and expenditures reasonably estimated as includible in inventory because of the agreement.

Information schedule. If you use this method of treating advance payments for future sales of goods, you must attach to your income tax return for each tax year, an information schedule containing the following information:

1) Total advance payments received in the current tax year;

2) Total advance payments received in earlier tax years that have not been included in income before the current tax year;

3) Total payments received in earlier tax years that have been included in income for the current tax year.

To adopt the method discussed above, it is necessary to secure prior consent from the Internal Revenue Service.

Amount of compensation accruable. If you use the accrual method and contract to perform services for a basic rate of monthly compensation but, as a matter of convenience, agree to receive monthly payments at a lower rate and to receive, upon completion of your services, the difference between the basic rate and the amount paid to you monthly, you must include the basic rate in your income as it accrues

Expenses. A person engaged in business, using the accrual method, will deduct business expenses when incurred, whether or not they are paid in the same tax year. All events fixing the liability must have occurred and the amount of the expense must be determinable with reasonable accuracy.

Example. You are a calendar-year taxpayer and in December 1975, you buy office supplies. You are billed in January 1976, and make payment in the same month. The expense is deductible in 1975 because the liability was incurred in that year.

Inventories are necessary to clearly reflect income in every case where the production, purchase, or sale of merchandise is an income-producing factor. If inventories are necessary to reflect income correctly, only the accrual method of accounting may be used for the purchases and sales. Inventories are discussed later.

Transactions between related taxpayers. If you use the accrual method you will not be allowed a deduction for ***unpaid business expenses or interest*** owed to a related taxpayer unless, with respect to such items of income, the ***related taxpayer*** (1) used the

accrual method, or (2) uses the cash method and the unpaid expenses or interest are received or constructively received by such related taxpayer within 2 1/2 months after the close of your tax year.

Special Methods

A special method of accounting is permitted for reporting income and expenses with regard to *Long-Term Contracts,* discussed later in this publication. Other special methods that are permitted or required under certain circumstances are discussed in other publications that are available free by mailing a post card to your Internal Revenue office. These relate to: reporting of installment sales by dealers in personal property (Publication 512); reporting of casual deferred-payment sales of real and personal property (Publication 537); treatment of certain business expenditures as either capital items or current business expenses (Publication 535); methods of depreciation (Publication 534); and amortization and depletion (Publication 535).

A Combination of Methods

Any combination of the foregoing methods of accounting will be permitted if the combination clearly reflects income and is applied consistently. This is known as a hybrid method. However, the treatment of certain items of income and expense must comply with the following specific requirements.

If you are engaged in a business, using an accrual method for computing gross profit from purchases and sales, you may use the cash method in computing all other items of income and expense. However, if you use the cash method in computing gross income from your business, you must use the cash method for business expenses. Similarly, if you use an accrual method for business expenses, you must use an accrual method for all items affecting gross income and in computing gross profit from your trade or business.

Business and personal items may be accounted for under different methods of accounting. Thus, you may compute the income from your business under an accrual method even though you use the cash method for personal items.

If you own more than one business you may use a different method of accounting for each ***separate and distinct*** business provided the method used for each clearly reflects income. For example, if you operate a personal service business and a manufacturing business, you may use the cash method for the personal service business but you must use the accrual method for the manufacturing business.

A business is not separate and distinct unless a complete and separate set of books and records is kept for it.

Other Methods of Accounting

You may be authorized to continue using a method of accounting that you have been using consistently, even though it is ***not*** one of those described previously, if, in the opinion of the Internal Revenue Service, it clearly reflects your income.

Inventories

The main types of inventories are:

1) Merchandise or stock in trade.
2) Raw materials
3) Work in process.
4) Finished products.
5) Supplies (which will physically become a part of the item intended for sale).

How to Inventory

To arrive at a dollar amount for your inventory you need: (1) a method for *identifying,* and (2) a basis for *valuing* the items in your inventory.

Inventory valuation rules cannot be uniform for all types of businesses but the method used must give effect to trade customs that come within the scope of the best accounting practice in your trade or business and it must clearly reflect income. To clearly reflect income, your inventory practice must be consistent from year to year.

Identification of Inventory

Items Included in Inventory

Inventories include all finished or partly finished goods and raw materials and supplies that will physically become a part of your merchandise intended for sale.

Merchandise should be included in inventory only if title to it is vested in you. You should include merchandise purchased, if title to it has passed to you, even though it is in transit or for other reasons you do not have physical possession. Your inventory should also include goods under contract for sale that you have not yet segregated and applied to the contract, and goods out on consignment. Also include items in display rooms, merchandise mart rooms or booths located away from your place of business.

Other methods of accounting for inventory may be acceptable if they are in accord with generally recognized and accepted accounting principles and are consistently used from year to year. For example, if you are a manufacturer, you may be permitted to account for the sale of your product when the goods are shipped, when the product is delivered or accepted, or when title to the goods passes to the customer, whether or not billed, depending upon the method regularly employed in keeping your books. These goods would not be included in your inventory.

Containers such as kegs, bottles, and cases, whether or not on hand and whether or not returnable, should be inventoried if title to them has not passed to a buyer of the contents. If title has passed to a buyer, you should exclude the containers from your inventory. Under certain circumstances, some containers may be depreciated See Publication 534, *Tax Information on Depreciation*

C.O.D. mail sales. If you sell merchandise by mail and intend that payment and delivery be concurrent, title passes when payment is made. Merchandise so shipped is excluded from sales and included in your closing inventory until paid for by the buyer

Items Excluded From Inventory

Exclude from your inventory all goods sold, but be sure that title to them has passed to the buyer. Also exclude goods in your possession that are consigned to you, goods in your possession that you have sold and title to which has passed to the buyer, and goods ordered by you for future delivery if the title to them has not passed to you

Assets such as land, buildings, equipment etc., used in your business, notes and accounts receivable, and similar assets, are not to be included in your inventory

A real estate dealer is not permitted to inventory the real estate held for sale in the ordinary course of business

Expenses of operating your business other than those directly applicable, in whole or part, to your cost of goods held for sale are deducted from your gross income and are not added to your inventory value.

Supplies on hand at the end of the year that do not physically become part of goods manufactured and intended for sale are not included in inventory. The cost of such supplies are deducted as expenses to the extent they are actually consumed and used during the tax year, provided that this cost has not been deducted in a prior year.

Identifying Items With Their Costs

Identifying items in an inventory with their costs may mean matching the goods with their invoices (less appropriate discounts) to find the cost of each inventoried item This is called the *specific identification* method

If there is no specific identification of items with their costs, an assumption must be made to determine which items were sold and which remain in inventory. This identification may be accomplished by either *the first-in first-out* method, or *the last-in first-out method.*

The first-in first-out (FIFO) method is based on the assumption that the items first purchased or produced are the first sold, consumed or otherwise disposed of.

Example. At the end of your tax year your books show the following data on item A:

Jan 1	Opening Inventory	20 units—$10 per unit	$200
May 12	Purchase	40 units—9 per unit	360
Aug 25	Purchase	30 units—11 per unit	330
Nov 5	Purchase	10 units—12 per unit	120
Total		100 units	$1,010

A physical inventory on December 31 shows 30 units of item A. Your inventory would be considered to be composed of the most recent items as follows:

Most recent purchase, Nov 5	10 units—$12 per unit	$120
Next most recent purchase Aug 25	20 units—11 per unit	220
Inventory for item A	30 units	$340

The last-in first-out (LIFO) method is a special method for determining the cost of items or groups of items in the inventory. Under this method items in the ending inventory are considered to be those included in the opening inventory plus those acquired during the year in LIFO order. LIFO may be adopted and used if the taxpayer files Form 970 pursuant to the instructions thereon. In lieu of filing Form 970, you may elect LIFO by submitting all the information required on that form with your timely filed tax return for the year for which you first elect LIFO. Since very complex rules are involved and because LIFO is not ordinarily used by small businesses, the method is not discussed in this publication.

Valuation of Inventory

Valuing the items in your inventory is a major factor in the measurement of taxable income, and the adoption of a sound valuation policy is of prime importance. There are two bases of valuation most commonly used by business concerns using the first-in first-out inventory method: (1) cost; (2) cost or market, whichever is lower.

A new business may use either the cost or the cost or market, whichever is lower, basis of valuing the inventory. But, if the last-in first-out method of identification is used, then valuation must be on the cost basis. Whichever basis is adopted, it must be applied to the entire inventory, and may not be changed without the permission of the Internal Revenue Service.

Cost Basis

Several pricing methods recognized for tax purposes may be used to properly arrive at the cost basis of your inventory. The dollar value resulting from your selected method is the cost basis of the inventory. Several commonly used methods are discussed below.

Specific Cost Identification Method

The cost of merchandise purchased during the year is ordinarily invoice price minus appropriate discounts. If this method is used in arriving at the inventory value of merchandise, materials or supplies, cost means: ***1) For goods on hand at the beginning of the year***—The inventory price of the goods. ***2) For goods purchased during the year***—Invoice price less appropriate discounts. You may or may not deduct cash discounts at your option, but you must follow a consistent policy. If you do not deduct cash discounts you must include them in business income. Transportation or other necessary charges incurred in acquiring the goods are added to the net invoice price.

Full Absorption Method

This method is required for all taxpayers engaged in manufacturing or production operations. Both direct and indirect production costs must be taken into account in your computation of inventory costs.

Direct production costs are generally those costs which are incident to and necessary for production or manufacturing operations or processes and are components of the cost of either direct material or direct labor. Direct material costs include the cost of those materials which become an integral part of a specific product and those materials which are consumed in the ordinary course of manufacturing and can be identified with particular units or groups of units of the product.

Direct labor costs include the cost of labor which can be identified with or associated with particular units or groups of units of a specific product. Direct labor includes such items as basic compensation, overtime pay, vacation and holiday pay, sick leave pay (other than payments pursuant to a wage continuation plan which provide payments in lieu of wages for a period during which an employee is absent from work on account of personal injuries or sickness), shift differential, payroll taxes, and payments to a supplemental unemployment benefits plan paid or incurred on behalf of employees engaged in direct labor.

General Rule for indirect costs. The indirect costs which must enter into the computation of inventory costs (regardless of their treatment in your financial statements) include repairs, maintenance, utilities, rent, indirect labor and production supervisory wages, indirect materials, tools and equipment (not capitalized), and quality control costs. These costs must be included in inventory costs to the extent such costs are incident to and necessary for the production process.

Costs not required to be included in your inventory costs (regardless of their treatment in financial statements) include: (a) losses under Section 165 of the Internal Revenue Code; (b) percentage depletion in excess of cost depletion; (c) depreciation and amortization reported for Federal income tax purposes, in excess of that reported in your financial reports; (d) pension contributions representing past service costs; (e) officers' salaries and administrative expenses, which are incident to and necessary for your business operations as a whole, rather than to production operations; (f) research and experimental expenses; (g) interest expense, and (h) expenses for marketing, advertising, selling, and distribution.

Other indirect costs may or may not be included as inventory cost. Inclusion or exclusion of these costs from the amount of inventory costs for your financial reports determines whether these costs must be included or excluded from your inventory costs for tax purposes. Your financial statements must be prepared in accordance with generally accepted accounting principles. The costs in this category are: (a) taxes otherwise allowable as a deduction (other than State, local, and foreign income taxes) attributable to assets incident to and necessary for production operations; (b) depreciation reported in financial reports and cost depletion on assets incident to and necessary for production operations; (c) pension and profit-sharing contributions representing current service costs otherwise allowable as a deduction, and other employee benefits otherwise deductible (such as workmen's compensation, wage continuation plan payments, premiums on life and health insurance, and miscellaneous benefits provided for safety, medical treatment, cafeteria, recreational facilities, membership dues, etc.) incurred for labor incident to and necessary for production or manufacturing operatons or processes; and (d) costs attributable to strikes, rework labor, scrap, spoilage, factory administrative costs officers' salaries, and insurance, incident to and necessary for production or manufacturing operations or processes.

Exception to General Rule for indirect costs. If you use a different method of accounting for production costs in your financial reports than you use for tax purposes, the following rules apply.

Indirect costs which must enter into the computation of inventory costs include those costs which are required to be included in inventory costs under the general rule, already mentioned. Additionally, the following expenses are required to be included in inventory costs: (a) taxes otherwise allowable as a deduction (other than State, local, and foreign income taxes); (b) depreciation and amortization reported for financial purposes; (c) cost depletion; (d) administrative costs of production (not including selling costs or return on capital), (e) officers' salaries, incident to and necessary for production or manufacturing operations or processes; and (f) insurance costs, incident to and necessary for production or manufacturing operations or processes

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There are only two categories of indirect costs under this exception to the general rule; those indirect costs that must be included in the computation of inventory costs and those indirect costs which may be excluded. Accordingly, indirect costs not specified may be excluded.

Method of Allocation. Indirect production costs required to be included in the computation of inventory costs must be allocated to goods manufactured during the year (including goods in your ending inventory) by a method which fairly apportions such costs among the various items produced. Acceptable methods for allocating indirect production costs to the costs of goods in the ending inventory include the manufacturing burden rate method and the standard cost method. In addition, the practical capacity concept can be used in conjunction with either the manufacturing burden rate or a standard cost method.

Transition to Full Absorption Method. If you are engaged in manufacturing or production, but not presently using the full absorption method, you must change to that method. This change is required for all your trades or businesses. See *Changing Your Method of Accounting*, discussed later, for information on how to make the change. If you are presently using a method of inventory costing which is more inclusive of indirect costs than the full absorption method, you may elect to change to the full absorption method.

Special election for change to full absorption method. A special election is available whereby you need not change to the full absorption method for tax years prior to the tax year for which such election is made. The election is made on Form 3115. Such election shall be made during the first 180 days of any tax year beginning on or after September 19, 1973. Generally, the latest date for making the election is November 28, 1975. However, if you are making the election for a tax year for which the first 180 days had not expired on or before April 17, 1975, you have until November 28, 1975 or the end of the 180 day period, whichever is later, to make the election.

The change in inventory costing method must be made for the tax year in which the special election is made.

If you make this election, the change in accounting method is considered to have been initiated by the Internal Revenue Service. The consent of the Internal Revenue Service will be evidenced by a letter of consent. Contact your Internal Revenue office about required adjustments.

Intermingled goods of the same type in inventory, that were purchased or produced at various prices during the year and that cannot be identified with specific invoices, will be deemed to be the goods most recently purchased or produced. If the quantity in the inventory exceeds the quantity purchased or produced at the last price, the excess will be inventoried at the next to the last price, and so on until the entire quantity is valued. This method is known as the first-in first-out method, described earlier.

Cost or Market Method

Lower of cost or market means that you compare the market value of each item on hand at the inventory date with its cost and use the lower valuation as its inventory value. Thus, if at the end of your tax year you had the following items on hand, the value of closing inventory would be $600.

Items	Cost	Market	Whichever is lower
R	$300	$500	$300
S	200	100	100
T	450	200	200
Totals	$950	$800	$600

If you use this method, you must value each item in the inventory. You may not value the entire inventory at cost ($950) and at market ($800) and use the lower of the two results. If you used the cost basis of valuation, the value of your closing inventory would be $950.

Market value, under ordinary circumstances and for normal goods, means the bid price prevailing at the date of your inventory. This price is based on the volume of merchandise you usually buy. Thus, if you buy items in small lots at $10 an item and Mr. Smith buys identical items in larger lots at $8.50 an item, your prevailing market price will be higher than Mr. Smith's.

This rule applies to (1) goods purchased and on hand, (2) basic elements of cost (materials, labor and overhead) of goods in process of manufacture and finished goods on hand. It does not apply to goods on hand or in process of manufacture, for delivery at fixed prices upon a firm sales contract (i.e., not legally subject to cancellation by either you or the buyer). Such goods must be inventoried at cost.

Lower than market. When, in the regular course of business, you have offered merchandise for sale at prices lower than market (as defined previously), the inventory may be valued at these prices less direct costs of disposition. These prices are to be determined by reference to the actual sales for a reasonable period before and after the date of your inventory. Prices that vary materially from the actual prices determined will not be acceptable.

If no market exists, or if quotations are nominal because of an inactive market, you must use such evidence of a fair market price as may be available, at the date or dates nearest your inventory date. This evidence could include specific purchases or sales you or others made in reasonable volume and in good faith, or compensation paid for cancellation of contracts for purchase commitments.

Unsalable Goods

Any goods in your inventory that are unsalable at normal prices or unsalable in the normal way should be valued at selling prices less direct costs of disposition, whether you use the cost, or cost or market, whichever is lower, basis of valuing your inventory. This includes goods that are unsalable because of damage, imperfections, shop wear, changes of style, off or broken lots, or other similar causes, including second hand goods taken in exchange. If these goods consist of raw materials or partly finished goods held for use or consumption, they must be valued upon a reasonable basis, considering the usability and condition of the goods, but in no case shall they be valued at less than scrap value.

Perpetual or Book Inventories

Perpetual or book inventories, maintained in accordance with sound accounting practices, are acceptable for determining the cost of goods on hand. Inventory accounts, however, must be charged with the actual cost of goods purchased or produced and credited with the value of goods used, transferred, or sold. Credits must be calculated on the basis of actual cost of goods acquired during the year and the inventory value at the beginning of the year.

Physical inventories must be taken at reasonable intervals and the book figure for inventory must be adjusted to conform with the actual inventory. If you use the lower of cost or market basis of valuation of your book inventory, cost so adjusted at the close of each tax year must be compared with the market value of each article on hand at the inventory date.

Practices Not Approved

Among others, the following practices of taking or valuing inventories are not recognized for tax purposes:

1) Deducting a reserve for price changes or an estimated amount for depreciation in the value of your inventory;
2) Taking work in process or other parts of your inventory at a nominal price or less than its proper value;
3) Omitting portions of your stock on hand;
4) Using a constant price or nominal value for so-called normal quantity of materials or goods in stock; or
5) Including stock in transit, shipped either to or by you, the title to which you do not hold, as noted previously;
6) Segregating indirect production costs into fixed and variable production cost classifications and allocating only the vari-

able costs to cost of goods produced while treating fixed costs as period costs that are currently deductible (the "direct cost" method); or

7) Treating all or substantially all indirect production costs (whether fixed or variable) as period costs that are currently deductible (the "prime cost" method).

Time and Manner of Electing Method

New businesses may adopt any inventory method and basis explained previously if the method and basis are applicable to the business and clearly reflect income. Generally, you may elect a method and basis for inventories by computing your income under that method and basis in the first return you file for the period in which the business began.

To change your inventory method or basis, you must follow the rules explained later under *Changing Your Method of Accounting.*

Gains and Losses

Damage from fire or other casualty, or theft of items included in inventory, may result in a casualty or theft loss. See Publication 547, *Tax Information on Disasters, Casualty Losses, and Thefts.* The loss suffered from such casualty or theft is usually reflected in the valuation of your closing inventory.

Sale of entire inventory. The total amount realized from the sale of your entire inventory is included in your return as ordinary income. For the sale of an entire inventory, such as when you sell or dispose of your business, see Publication 543, *Sales or Other Dispositions of a Business or Business Interest*

Changing Your Method of Accounting

A taxpayer filing his or her first return may, without the consent of the Commissioner, choose any appropriate method of accounting. The method adopted must clearly reflect income and be applied consistently.

Thereafter, any change in your method of accounting requires the prior consent of the Commissioner. You are not forbidden to change your method but are required to obtain the consent of the Commissioner before making the change. This is necessary to put the Internal Revenue Service on notice that a change is being made and to prevent a taxpayer from gaining an unwarranted tax advantage.

A change in the method of accounting includes a change not only in the overall system of accounting but also in the treatment of any particular material item. Although an accounting method may exist without having a pattern of consistent treatment of an item, in most instances, a method of accounting is not established for an item *without* such consistent treatment.

Some examples of changes *requiring* consent are:

1) A change from the cash to the accrual method or vice versa;

2) A change in the method or basis used in the valuation of inventories;

3) A change in the method of computing depreciation (except certain changes to the straight-line method explained in Publication 534, *Tax Information on Depreciation*);

4) A change from the cash or accrual method to a long-term contract method or vice versa.

Some examples of changes that are not changes in methods of accounting and *do not require* consent are:

1) A correction of mathematical or posting errors;

2) An adjustment of any item of income or deduction which does not involve the proper time for its inclusion in income or its deduction;

3) An adjustment with respect to the addition to a reserve for bad debts;

4) An adjustment in the useful life of a depreciable asset;

5) Election of the Asset Depreciation Range (ADR) System for computing depreciation allowances, as discussed in Publication 534.

How to secure consent. Unless you are a taxpayer making a change under Revenue Procedures 64–51, or 74–11 (discussed later) you must file Form 3115, *Application for Change in Accounting Method,* with the Commissioner of Internal Revenue, Attention: T:C:C: AM&P, Washington, D.C. 20224.

The Form 3115 is available at your Internal Revenue office. To the extent applicable, you must furnish all the information requested on the form. You may also be required to submit additional information, if necessary, to determine whether the proposed change will be granted.

The application must be filed within the first 180 days of the tax year for which the change is requested. Thus, a calendar-year taxpayer wishing to change his or her accounting method for the year 1976 must file by June 28, 1976.

Change from cash method to accrual method. If you want to change your accounting method from the cash receipts and disbursements method to an accrual method, you must receive consent from the Internal Revenue Service. Consent may be secured by filing Form 3115, as explained previously. You should furnish all information requested on that form.

You should request the application of Revenue Procedure 70-27, 1970-2 C.B. 509. Your request to change from the cash method to the accrual method will ordinarily receive favorable consideration, providing you propose and agree to take the necessary adjustments into account over an appropriate period, prescribed by the Internal Revenue Service, generally 10 years

An application on Form 3115 filed after the 180 day period but within 9 months after the beginning of the tax year for which the change is requested may be considered as timely filed upon a showing of good cause by the taxpayer.

Simplified procedures now exist under which you may, in certain cases, be deemed to have obtained the Commissioner's consent to your change of method of computing depreciation to certain other methods. See Revenue Procedure 74–11, 1974–1, C.B. 420. A simplified procedure also exists whereby you may change from the specific charge off method to the reserve method in your accounting for bad debts. See Revenue Procedure 64–51, 1964–2 C.B., 1003. These procedures may be obtained from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

An application on Form 3115 filed under any of these procedures will be filed with the Service Center for the district where you file your return. If you follow the steps outlined in the procedures and comply with all the provisions, you may assume consent has been granted unless you are notified otherwise.

Examination of return. If your return is being examined by the Internal Revenue Service and the issue involves a change in accounting practice or method you may request application of Rev. Proc. 70–27, 1970–2 C.B. 509. In such case, the Revenue Procedure will generally apply to the most recent tax year (year of transition) for which a Federal income tax return has been filed. Your request for application of the Revenue Procedure should be made in a letter to the Commissioner of Internal Revenue, Attention T:C:C. This request should be sent to the District Director for the district in which the return is being examined and he will forward it with his comments to the National Office. The letter should be accompanied by a completed Form 3115. Pending completion of action by the National Office, the District Director will suspend action on the particular issue.

After your request is made, you may ask for a conference in the National Office to discuss the matter. Rev. Proc. 70–27, does not apply to cases under examination by the Service in which the year or years under examination encompass the tax year in which the erroneous practice or method was initiated by you. Additionally Rev. Proc. 70–27 does not apply when changing to the full absorption method of inventory costing

How to Compute Net Profit

The following example illustrates a combination of both the accrual and the cash receipts and disbursements methods.

Gross profit from sales in the example is determined under an accrual method.

Expenses of doing business, other than cost of goods sold, are deducted under the cash method.

Example. Sally Small operated a retail grocery store during 1975. Her cash sales were $68,025 and her sales on open account were $9,035—a total of $77,060. She had an opening inventory of $7,845 and a closing inventory of $7,955. Merchandise purchases, less cost of items withdrawn for personal use during the year, totaled $60,250. This figure of $60,250 contains purchases not paid for by the end of 1975. Her expenses amounted to $7,375, which included $250 depreciation on store fixtures, business bad debts of $110, rent of $200 per month (she paid for only 11 months) and repairs of $25. (She still owed $50 for repairs which may not be deducted until actually paid.) Her net profit from the business is computed as follows:

PROFIT AND LOSS STATEMENT

YEAR ENDED DECEMBER 31, 1975

Sales (less returns and allowances)		$77,060
Less Cost of Goods Sold		
Inventory 1/1/75	$ 7,845	
Purchases (less personal items)	60,250	
Goods available for sale	$68,095	
Less Inventory 12/31/75	7,955	
Cost of Goods Sold		60,140
Gross Profit		$16,920
Less Expenses		
Rent	$2,200	
Interest	150	
Licenses	120	
Bad debts	110	
Depreciation	250	
Repairs	25	
Other business expenses	4,520	7,375
Net profit from business		$ 9,545

Discounting notes receivable is a common practice in some businesses. Many dealers receive notes of customers, payable over fixed periods, as part payment for articles sold. The dealer then sells the notes to a finance company at a discount. The dealer and the finance company often agree that a portion of the discount price will be retained by the finance company in a ***dealer's reserve*** or comparable account until collections are made or the reserve reaches a specified total, at which time it will be paid over or credited to the dealer. This practice is often followed by automobile dealers.

Amounts held in the reserve, in such cases, cannot be excluded from income. The full amount of the ***discount price,*** undiminished by the portion retained by the finance company, is properly included in income on an accrual method of accounting when the notes are sold.

Losses on worthless notes that the finance company may charge against the reserve have no bearing on the fact that taxable income has been received by the dealer.

Repaying income previously reported. If you included an amount in your income because it appeared that you had an unrestricted right to it and in a later year are required to repay the amount, or a part of it, because it turns out that you did not have an unrestricted right to the income, a special rule may apply. Ordinarily, you are allowed to deduct the repayment in the year in which it is made.

The character of the deduction in the year of repayment is determined by referring back to the transaction in the earlier year. For instance, the repayment of an amount previously reported as a long-term capital gain will be treated as a long-term capital loss.

If such a deduction is over $3,000, the tax for the year of the repayment is the lesser of the following:

1) The tax computed with the deduction; or

2) The tax computed without the deduction, but reduced by the amount by which the tax for the prior year would have been reduced if the item had not been included in income in that year. If this procedure is used, however, the amount repaid may not be deducted in computing a net operating loss for the year of repayment.

The computation pertaining to a deduction of this type in excess of $3,000 does not apply to:

1) Deductions for items that were included in gross income because of the sale or other disposition of stock-in-trade of the taxpayer;
2) Deductions for items that would have been included in the inventory of the taxpayer if on hand at the close of the earlier tax year; or
3) Property held by a taxpayer primarily for sale to customers in the ordinary course of his or her trade or business.

It does not apply, therefore, to sales returns and allowances and similar items. Nor does it apply to deductions attributable to bad debts or to legal fees and other expenses incurred in contesting the repayment of income previously included.

How to account for such repayments. If you use the cash method, to be entitled to a deduction in the later year for an item of income included in an earlier year under a claim of right, the amount must be actually repaid. If you use any other method, the deduction resulting from the repayment may be taken only in the proper tax year under the method of accounting you use in computing taxable income.

Contested Liabilities

If you contest an asserted liability, for any of your business expenses, the amount you paid may or may not be deductible in the year you paid it.

If you use the cash method you may deduct the contested liability for allowable business expenses only in the year paid.

An accrual method taxpayer must deduct certain contested liabilities (such as taxes, except foreign taxes) in the tax year in which the disputed liabilities are paid (or when a transfer of money or other property is made to provide for the satisfaction of the obligation) rather than in the tax year in which the contest is settled. However, for the deduction to be allowed in the year of payment or transfer, each of the following general rules must be satisfied.

1) ***You must contest an asserted liability.*** You do not have to institute a suit in a court of law to contest an asserted liability. However, you must deny its validity or accuracy by an affirmative act. A written protest included with payment of an asserted liability is sufficient to commence a contest. Lodging a protest in accordance with local law is sufficient to contest an asserted liability for tax. You do not have to deny the validity or accuracy of an asserted liability in writing if you can establish, by all the facts and circumstances, that a liability has been asserted and contested.

2) ***You must transfer to the creditor or other person, sufficient money or other property to provide for the satisfaction of the asserted liability.*** The money or other property transferred must be beyond your control. If you transfer it to an escrow agent, you have satisfied this requirement, provided you relinquish all authority over the money or other property. However, purchasing a bond to guarantee payment of the asserted liability, making an entry on your books of account, or a transfer to an account within your control is ***not*** a transfer to provide for the satisfaction of an asserted liability.

3) ***The contest with respect to the asserted liability must exist after the time of the transfer.*** If payment is not made until after the contest is settled, you must accrue the liability in the year in which the contest is settled.

Example. You are a calendar-year taxpayer using the accrual method of accounting, and had a $100 liability asserted against you in 1972. This asserted liability was contested, and finally settled in 1975 for the full $100. You will pay the $100 in 1976. Since the payment was not made until after the contest was settled, the liability will accrue and be deductible in 1975.

4) ***The liability must have been allowable as a deduction in the year of payment,*** or in an earlier year when it would have accrued, had there been no contest.

Recovered amounts. If any portion of the contested liability deducted in the tax year of payment is recovered in a later tax year when the contest is settled, an adjustment is generally necessary. This is accomplished by including in gross income in the tax year of final settlement the portion of the ***recovered amount*** that, when deducted, caused a decrease in tax for any tax year.

Trading Stamps

If you issue trading stamps or premium coupons with your sales and these stamps or coupons are redeemable by you, a reduction in your gross receipts is permitted. This reduction is also permitted if you are engaged in the business of selling trading stamps or premium coupons, which are redeemable by you. You must be an accrual method taxpayer to make this reduction.

Your gross receipts from the sales of such stamps or coupons (or from the sales for which the stamps or coupons are issued) should be reduced by an amount equal to:

a) Your cost of merchandise, cash, or other property used for redemptions in the taxable year; and

b) The net addition to, or subtraction from, the provision for future redemptions during the tax year.

A taxpayer will be considered as ***engaged in the business of selling trading stamps or premium coupons*** if:

1) The trading stamps or premium coupons sold by him are issued by purchasers to promote the sale of their merchandise or services;

2) The principal activity of his trade or business is the sale of trading stamps or premium coupons;

3) The stamps or coupons may be redeemed by the taxpayer for a period of at least one year from the date of sale; and

4) Based on his experience, he estimates that no more than two-thirds of the stamps or coupons sold, which it is estimated will be redeemed, will be redeemed within 6 months of the sale date.

The provision for future redemptions as of the end of a taxable year is computed by multiplying "estimated future redemptions" by the estimated average cost of redeeming each trading stamp or coupon. The term "estimated future redemptions" as of the end of a taxable year means the number of trading stamps or coupons outstanding that, it is estimated will ultimately be presented for redemption.

Five year rule. Estimated future redemptions may be determined by:

a. Computing the percentage which the total number of stamps or coupons redeemed in the taxable year and the 4 preceding taxable years is of the total number of stamps or coupons issued or sold in those 5 years, and

b. Multiplying that percentage by an appropriate growth factor according to the guidelines set forth by the Internal Revenue Service in Revenue Procedure 72-36.

The volume of stamps expected to be redeemed after the close of any taxable year may be estimated by any of the following four general methods:

1) A ratio method;

2) The probability sampling method;

3) A synthetic or reconstructive method; or

4) Any actuarial, statistical or other mathematical method, provided that you can demonstrate satisfactorily that such a method will produce a sound and acceptable measurement of the volume of stamps expected to be redeemed by you after the close of any taxable year

These methods are discussed in detail in Revenue Procedure 72-36, 1972-2 C.B. 771.

You are required to choose a method that is appropriate to your experience and circumstances. If the Internal Revenue Service is not satisfied that your method is appropriate and produces reasonably accurate results, you will be required to recompute your estimated volume in a manner satisfactory to the Internal Revenue Service.

Other methods. You may determine your estimated future redemption by any other method, including probability sampling techniques, the accuracy and reliability of which can be demonstrated to the satisfaction of your local District Director.

Information to be furnished with your return. If you compute your estimated future redemptions under the 5-year rule, file with your return a statement showing the total number of stamps or coupons issued or redeemed for the last 5 tax years. If you use any other method of computing your estimated future redemption, file with your return any information necessary to establish the correctness of the amount you subtracted from gross receipts in the taxable year.

Long-Term Contracts

Special methods of accounting may be used for reporting income from long-term contracts. However, permission from the Internal Revenue Service is required for a change to or from these special methods.

A contractor who has a building, installation, or construction contract covering a period of more than 1 year from the date of execution to the date of completion and acceptance may report income from the contract by either the percentage of completion method or the completed-contract method

You must attach a statement to your tax return indicating that you are using one of the long-term contract methods of accounting each year you report income under it Contracts involving the mere sale of completed property do not qualify

The percentage of completion method provides that you report as gross income only that part of the contract price which represents the percentage of the entire contract completed during your current tax year

Deduct all costs incurred during your tax year in connection with the contract. However, to determine the deduction for materials and supplies, add the cost of those materials and supplies on hand at the beginning of the year to purchases during the year and subtract the material and supplies on hand at the end of the year

A certificate of the architect or engineer, showing the percentage of completion during your tax year of the entire work to be performed under the contract, must be available at your principal place of business for inspection in connection with an audit of your income tax return by the Internal Revenue Service

Example. Mary Hammond has a contract for the construction of a building. The contract was executed June 23, 1975, and provides for payment of $180,000 for a building to be completed by November 14, 1976. She uses the calendar year as her tax year, began construction July 1, 1975. She elects to use the percentage of completion method, above. The architect certified that 25% of the work was completed on December 31, 1975 Mary Hammond will report gross income from the contract of $45,000 for 1975. She also will deduct all her 1975 expenditures in connection with the contract, taking account of her materials and supplies on hand at the end of the year as stated above

The completed-contract method provides that you report gross income from a long-term contract and deduct all expenses properly allocable to it in the year the contract is finally completed and accepted. However, you may not deduct the cost of any materials and supplies charged to the work under the contract but remaining on hand at the time of completion. Depreciation and other overhead costs must be allocated to specific jobs.

Example. A contractor using the completed-contract method entered into a contract in 1973 to construct a building that was finally completed and accepted in 1975. His expenses, allocated to the job, were $50,000 during 1973, $90,000 during 1974, and $30,000 during 1975. He received $80,000 during 1973, $100,000 during 1974, and $35,000 during 1975 as payments from the contract. His income tax returns for 1973 and 1974 show no income or expenses attribut-

able to this particular contract. His income tax return for 1975 will disclose the total income and expenses of this job and will reflect his profit of $45,000 from this contract.

Unanticipated expenditures made in a year subsequent to the completion of a contract are deductible in the year incurred and not in the year that the contract was completed.

Other expenses, such as office salaries, rent, taxes, etc., not directly attributable to a long-term contract, are deductible only in the year paid or incurred, depending on the method of accounting you otherwise use. These expenses may not, under any circumstances, be made part of the computations under the percentage of completion or the completed-contract methods.

Change of method. You may elect to change to either of the above methods of reporting income from long-term contracts only with the permission of the Internal Revenue Service. If you elect to use either the percentage of completion method or the completed-contract method, you may not later change to another method without permission. You will also be required to use the method elected for any other long-term contracts you may secure, unless you get permission from the Service to change to another recognized method.

Accounting Periods

Every taxpayer must compute his or her taxable income and file a return on the basis of a period of time called a tax year.

A tax year is usually 12 consecutive months. It may be a calendar year or a fiscal year (including a period of 52 or 53 weeks). Under certain conditions your tax year may be less than 12 months, but it may not be more than 12 months unless you use a 52–53 week year.

A calendar year is 12 consecutive months ending on December 31.

A fiscal year is either 12 consecutive months ending on the last day of any month other than December, or a 52–53 week year. To report on a fiscal year basis, books must be kept on that basis. See *A 52–53 week year*, later.

A short period is a tax year of less than 12 months. A short period return is treated as a return for a full tax year.

Establishing the Tax Year

A new taxpayer may adopt either a calendar or a fiscal year. The first tax year ***must*** be adopted on or before the time prescribed by law (not including extensions) for the filing of a return for that tax year.

Tax year of partnership. If the principal partners (those having more than a 5% interest in the partnership) have different tax years, a newly formed partnership may adopt the calendar year without prior approval of the Internal Revenue Service. The newly formed partnership also may adopt the tax year of all of its principal partners (or the tax year to which all the principal partners are concurrently changing) without prior approval. However, if the new partnership wishes to adopt any other tax year, it must first get the approval of the Internal Revenue Service.

You as an individual establish a tax year when you file your first income tax return. If in a later year you begin business as a sole proprietor, you must continue to use the same tax year unless you get permission to change as explained later. Your income from all sources, including your sole proprietorship, salaries, dividends, etc., must be reported on the basis of the same tax year.

Fiscal year taxpayer. Taxes withheld from your wages, as shown on your Form W-2, are a credit against your income tax liability. If you are a fiscal year taxpayer, you would claim this credit for your fiscal year in which the calendar year covered by Form W-2 ends.

A 52–53 week year may be used as the tax year if you keep your books on that basis. This is a fiscal year that:

1) Varies from 52 to 53 weeks;

2) Ends always on the same day of the week; and

3) Ends as of the date that day last falls in a particular calendar month or the date it falls nearest the end of a particular calendar month.

For example, if you elect a tax year ending on the last Saturday in March 1976, your tax year will end on March 27. On the other hand, if you elect a tax year ending on the Saturday ***nearest the end*** of March, then your 1976 tax year will end on April 3.

You make the election by filing your return for the 52–53 week year and attaching to it a statement showing:

1) The day of the week upon which the tax year will always end;

2) Whether it will end on the last such day of the week occuring in the calendar month or on the date such day of the week occurs nearest the end of the month; and

3) The month in which or with reference to which the tax year will end.

In computing depreciation, a 52–53 week year is considered a year of 12 full months, unless some other practice has been consistently followed in the past.

In computing amortization, a 52–53 week year is considered a year of 12 full months.

For determining the due dates of returns or the effective dates of other provisions of the law expressed in terms of tax years beginning or ending with reference to the first or last day of a specified calendar month, a 52–53 week year is considered to begin on the 1st day of the calendar month nearest to the 1st day of the 52–53 week year. The 52–53 week year is considered to end on the last day of the calendar month ending nearest to the last day of the 52–53 week year. For individuals, the due date for filing a return is the 15th day of the 4th month after the close of the tax year, and for a corporation, the due date is the 15th day of the 3rd month after the close of the tax year.

Example 1. A corporation uses a 52–53 week year that ends on the last Saturday in March. For the year ended March 27, 1976, it is required to file Form 1120 on or before June 15, 1976. If its year ended on the Saturday nearest to the end of March, it would not end until April 3, 1976, but Form 1120 would still be due on or before June 15, 1976. In both cases, the year is considered to end on March 31, 1976.

Example 2. Assume that an income tax provision applies to tax years beginning on or after January 1, 1976. For that purpose, a 52–53 week tax year beginning on any day within the period December 26, 1975, to January 4, 1976, inclusive, will be treated as beginning on January 1, 1976.

Changing Your Tax Year

You must, with certain exceptions, obtain prior approval from the Commissioner of Internal Revenue to change your annual accounting period.

Application for approval to change your accounting period should be made on Form 1128. This form must be filed on or before the 15th day of the second calendar month following the close of the short tax year. This period begins with the first day after the end of your present accounting period and ends on the day preceding the opening date of your new accounting period. Application should be made in triplicate on Form 1128, available at any Internal Revenue office, and should be sent to the Commissioner of Internal Revenue, Washington, D.C. 20224, Attn: T:C:C: AM&P.

Your application should contain all of the information requested. It should show that there is a substantial business purpose for the change and that any tax advantage resulting from it will not be significant. No change should be made until the Commissioner has approved your request.

If approval is granted, you must file an income tax return for the short period. There are special rules for computing the tax for a short year caused by a change in accounting period. See *Computation of Tax for Short Period*, later.

A partnership must file an application with the Commissioner if it wishes to adopt a tax year different from the tax year of its principal partners.

A corporation (other than a Subchapter S corporation) may change its annual accounting period without prior approval of the Commissioner if the following conditions are met.

1) The corporation must not have changed its tax year any time within the 10 calendar years ending with the calendar year in which the short period resulting from the change begins.

2) The short period must not be a tax year in which the corporation has a net operating loss.

3) The taxable income of the corporation for the short period must be (when annualized) 80% or more of the taxable income of the corporation for the tax year preceding the short period.

4) If the corporation is a personal holding company, foreign personal holding company, exempt organization, foreign corporation not engaged in trade or business within the United States, Western Hemisphere trade corporation, or China Trade Act corporation ***either*** for the short period or for the preceding tax year, it must have such status for ***both*** the short period and the preceding tax year; and

5) The corporation does not try to make an election as a Subchapter S corporation for the tax year which would immediately follow the short period required to effect the change.

A statement on behalf of the corporation must be filed with the Internal Revenue office where the corporation's tax returns are filed, on or before the time for filing the return for the short period required by the change.

The statement must indicate that the corporation is changing its annual accounting period under Section 1.442–1 (c) of the Income Tax Regulations and must contain information indicating that all the above conditions have been met. If, upon examination, the corporation does not meet all the conditions because of later adjustments in establishing tax liability, the statement will be considered a timely application for permission to change the corporation's annual accounting period to the tax year indicated in the statement.

A Subchapter S corporation may not change its annual accounting period without securing prior approval of the Commissioner.

If your records are inadequate or you have an accounting period that does not meet the requirements for a fiscal year, your tax year shall be the calendar year. In this case, the adoption of a fiscal year will be treated as a change in your annual accounting period and prior approval of the Commissioner will be required.

You may change to a 52–53 week year that ends with reference to the end of the ***same month*** with which your present tax year ends, without prior permission from the Commissioner.

Example. If you now use a calendar year and want to change to a 52–53 week year ending on the Thursday closest to December 31, prior approval is not needed. ***You make the election to change*** when prior approval is not required by filing with your return the statement described previously under *52–53 week year.*

Approval required. If you change to a 52–53 week tax year that ends with reference to the end of a month that is ***not the same month*** in which your old tax year ended, you must obtain prior approval of the Commissioner, as explained previously.

Example. If you use a calendar year and want to change to a 52–53 week year ending on the Saturday nearest the end of November, you must obtain prior approval of the Commissioner.

A change from a 52–53 week year to any other tax year, including another 52–53 week year, requires prior approval of the Commissioner. See *Application for approval,* previously discussed.

Husband and wife. The following rules apply to a spouse wishing to change his or her accounting period to that of the other spouse so they may file a joint return.

Newlyweds. A newly married wife or husband may adopt the accounting period of the other spouse without prior approval, and they may file a joint return for the first tax year ending after the date of marriage if

1) The due date for filing the required separate short period return of the spouse wishing to change (the 15th day of the 4th month following the end of the short period) falls on or after the date of the marriage; and
2) The return for the short period is timely filed.

If, on the date of the marriage, the due date for filing the required separate return has passed, they may not file a joint return until the second tax year ending after the date of the marriage, and then only if a timely short period return is filed for that year. The short period return filed in the first or second tax year after the date of marriage must be accompanied by a statement that the accounting period is being changed under authority of Section 1.442–1(e) of the Income Tax Regulations.

Example 1. John and Jane were married on July 31, 1975. John filed his return on the basis of a fiscal year ending June 30. Jane uses the calendar year, but wishes to change to John's fiscal year so they may file a joint return. If Jane files a separate return by October 15, 1975 for the short period January 1 through June 30, 1975, she will have changed her accounting period to a fiscal year ending June 30. Then she and John may file a joint return for their tax year ending June 30, 1976.

Example 2. If John and Jane were not married until October 16, 1975 (one day after the last day Jane could file a timely short period return for the first year of their marriage), they must file separate returns for the first tax year ending after the date of their marriage. If Jane files a timely separate return for the short period January 1 through June 30, 1976, they may file a joint return for their tax year ending June 30, 1977, and for future years.

Any other husband or wife wishing to change to the accounting period of the other spouse so that they may file a joint return must make proper application to the Commissioner of Internal Revenue. Permission may be granted for this reason in appropriate cases, even though no substantial business purpose for requesting the change is established.

Short Tax Year

A return is required for the period a taxpayer is in existence, even if ***not for a full tax year.*** In general, the return in this case is considered a return for a full tax year. Therefore, income for the period covered is ***not*** required to be ***annualized,*** as in the case of short periods due to a change of accounting period, described later. Requirements for filing the return and paying the tax are generally the same as if the return were for a full tax year of 12 months that ended on the last day of the short period. However, the due date for filing the last return of a ***deceased*** taxpayer is the same as if the decedent had lived throughout his or her tax year.

Examples of the foregoing rules:

A new corporation that came into existence on July 1, 1975, and elected the calendar year as its tax year must file its return on or before March 15, 1976. The return would be for the period July 1, 1975, to December 31, 1975.

A calendar year corporation that dissolves on July 25, 1976, must file its final return on or before October 15, 1976, for the period January 1 to July 25, 1976.

A new partnership formed on September 13, 1975, is required to file its return on or before April 15, 1976, if it elects, or receives permission, to use the calendar year.

If an individual dies during his or her tax year, a return must be filed for the decedent on or before the 15th day of the 4th month following the close of the regular tax year.

Example. Agnes Jones had regularly used a calendar year. She died on March 6, 1975. Her last return for the period January 1—

March 6, 1975, must be filed on or before April 15, 1976.

Computation of Tax for Short Period

If the Commissioner approves the change in your tax year, you must compute the tax and file a return for the short period that begins with the 1st day after the end of your old tax period and ends on the day before the 1st day of your new period.

The return is due from a corporation on the 15th day of the 3rd month after the short period. Other taxpayers must file the return on or before the 15th day of the 4th month after the short period.

Example. If you have used the calendar year and obtain permission to use the fiscal year ending November 30, you must file a return for the short period beginning January 1 and ending November 30. If your business is a corporation, that return is due on or before February 15. For individuals and partnerships the return for the short period is due on or before March 15.

Although due dates are generally the 15th day of the month, if the 15th falls on a Saturday, Sunday or legal holiday then the due date is extended to the next succeeding business day.

The tax is computed for the short period by placing the short period's taxable income on an annual basis. This is the general rule. An exception is described later.

Individual taxpayers compute their income tax for the short period under the general rule in the following manner:

1) Determine your taxable income for the short period without taking into account your personal exemption and your exemptions for dependents;

2) Multiply the amount of your personal exemption and your exemptions for dependents by a fraction, the numerator of which is the number of months in the short year, and the denominator of which is 12;

3) Deduct the amount in (2) from the amount in (1);

4) Multiply the difference determined in (3) by 12 and divide by the number of months in the short period;

5) Compute the total tentative tax on the amount of the annualized income so determined; and

6) Multiply the amount of the total tentative tax determined in (5) by the number of months in the short period and divide by 12.

The standard deduction is not allowed when you are required to file a short period return because of a change in your accounting period.

Example. Mr. Jones has taxable income of $13,950 before considering exemptions for himself, his wife and two children. This income is for the 9-month period January 1 through September 30, 1975. This is how he will compute his tax on a joint return for that period.

1 $13,950 (income for short period)

2 $750 × 4 × 9/12 = $2,250

3 $13,950 − $2,250 = $11,700

4 $11,700 × 12/9 = $15,600 (annualized income)

5 Tax on $15,600 = $3 160 (tentative tax)

6 $3,160 × 9/12 = $2,370 (tax for short period)

Self-employment tax is computed on the actual self-employment income. The self-employment income is never annualized.

Corporations compute the tax for the short period under the general rule in the same manner described above for individuals. Of course, there is no adjustment for personal exemptions.

Example. A corporation makes a return, because of a change in its accounting period, for the 6-month short period ending June 30, 1975. It had taxable income of $40,000 during the short period thus its annualized taxable income is $80,000 ($40,000 × 12/6). Its tax liability is computed as follows:

Normal Tax			
20% of 1st $25 000		$ 5,000	
22% of 2nd $25,000		5,500	
Surtax			
Taxable income	$80,000		
Less Surtax Exemption	50 000		
	$30,000		
48% of $30,000		14 400	
Total Tax, (As Annualized)		$24 900	
Tax for (6 months) short period ($24 900 × 6/12)			$12 450

52–53 week year. If you change to or from a 52–53 week year, income for the short period must be annualized unless the period covered is 359 days or more, or 6 days or less. A short period of 359 days or more is treated as a full tax year, while a short period of 6 days or less is added to and deemed to be part of the following tax year. Thus, if you make the election to change to a 52–53 week year without changing the month with reference to which the tax year ends, the income for the short period will never be annualized.

Example 1. For years after 1974 you elect to change from the calendar year to a 52–53 week year ending on the Saturday nearest to December 31. You will file a return for the tax year from January 1, 1975 to December 27, 1975, in the same manner as for a regular tax year since the short period in this case is 361 days. Your next tax return would be filed for the period Sunday, December 28, 1975 to Saturday, January 1, 1977.

Example 2. Assume the same facts as in Example 1, except that for years after 1974, you elect a 52–53 week year ending on the Wednesday nearest to December 31. Were it not for the rule applying to short periods of 6 days or less, your first 52–53 week tax year return would be filed for a short period of 1 day (January 1, 1975). Because of the special rule, however, this day is added to your tax year covering the period from Thursday, January 2, 1975 to Wednesday, December 31, 1975.

Where prior approval is required because you change the month with reference to which the tax year ends, as explained before, you must file a return for the short period if that period covers more than 6 or less than 359 days. Thus, if you use a calendar year and the Commissioner approves your election to change in 1976 to a 52–53 week year ending on the Wednesday closest to August 31, you must file a return for the short period from January 1, 1976, to September 1, 1976.

Tax for the short period is then computed in the manner described previously, except that you ***annualize on a daily*** rather than a monthly basis. You use 365 instead of 12, and you use the number of days in the short period instead of the number of months in the short period. You use 365 in all cases, regardless of the actual number of days in the calendar year.

A special method of computing the tax for the short period is available which may result in less tax. Individuals and corporations may use this method if they comply with certain requirements. The procedure to be followed in most cases is as follows.

You must use the general rule when you file your return (with one exception described later) and pay the tax for your short period. You obtain the benefits of the special method by filing a claim for refund, after making the computation described below.

To use the special method you must first determine what your taxable income is for the 12-month period ***beginning*** with the first day of the short period. To do this you must, of course, wait until 12 months have elapsed since the beginning of the short period.

Example. Suppose, in the example above under *Individual taxpayers*, that Mr. Jones for the 12-month period from January 1 to December 31 had taxable income of $15,000 after deducting his 4 exemptions. He must determine the tax that would be due, just as if he were filing a return for such 12-month period. This amount is $3,010.

He must determine what his taxable income is for the short period after deducting his personal exemptions pro rata as explained previously.

He reduces the tax for the above 12-month period by multiplying it by a fraction in which the numerator is the taxable income for the short period and the denominator is the taxable income for the 12-month period. The result is the tax computed by the special method ($11,700/$15,000 × $3,010 = $2,347.80). He then compares the tax computed under the special method with the amount of tax reported and paid on his return for the short tax year. Mr. Jones would

file a claim for refund of $22.20 ($2,370 − $2,347.80). The claim must be accompanied by a statement showing the computation of the taxable income for the 12-month period and the computation of tax by the special method.

The tax cannot be less under the special method than it would be if the tax were computed on the ***actual income for the short period*** without placing it on an annual basis. In computing your tax on the actual income for the short period, for purposes of this limitation, you should deduct your personal exemptions in full.

Example. Mr. Jones has taxable income of $13,950 before considering exemptions for himself, his wife, and two children. This income is for the 9-month period January 1 through September 30, 1975. His tax on a joint return, computed on the actual income for the short period, without placing it on the annual basis, is computed as follows:

1. Taxable income—$10,950 ($13,950—$3,000)
2. Tax on $10,950 = $2,029

Since the $2,347.80 tax computed previously under the special method is not less than the $2,029 tax computed above, he may use the special method.

Exception—If a taxpayer is not in existence at the end of the 12-month period described above, or if the taxpayer is a corporation that has distributed substantially all of its assets before the end of such period, then the period to be used in the special method is the 12-month period ***ending*** with the last day of the short period.

If at the time the return for the short period is filed, it is known that the period to be used under the special method is the 12-month period ending with the last day of the short period, the tax for the short period may be determined under the special method at that time. In such case, the return for the short period should show the taxable income and computation of tax for the 12-month period together with the computation of the tax under the general rule. The return will then be considered an application for the benefits of the special method. The computations are the same as when the 12-month period beginning with the first day of the short period is used.

Tax preference income for short periods. There is a "minimum tax" on tax preference income items if the preferred items exceed $30,000 ($15,000 for a married person filing a separate return) plus the Federal income tax liability for the tax year.

To compute your exemption for a short tax year, multiply the $30,000 exemption by a fraction, the numerator of which is the number of days in your short tax year, the denominator of which is 365.

Example. You have tax preference income of $40,000 for your short year of 292 days. You compute your exemption as follows:

Tax preference income	$40 000
Exemption	
$30 000 × 292 − 365	24,000
Amount of tax preference income to be taxed	$16,000

A discussion of the minimum tax on tax preference income can be found in Publication 525, *Taxable Income and Nontaxable Income*, available free by sending a postcard to your Internal Revenue office.

Tax Withheld on Wages. You are entitled to a credit against your tax liability for federal income taxes withheld from your wages. This withholding is always on a calendar-year basis.

If you had more than one tax year begin in the same calendar year, the total amount withheld is required to be taken as a credit for the last tax year beginning in the calendar year.

Excise Tax Periods

You must account for most Federal excise taxes quarterly. Some excise taxes are payable on or before July 1 each year, or on the date you first become liable for them. The quarters covered, in most cases, are:

Calendar quarter	Calendar months
First	January February March
Second	April May June
Third	July August September
Fourth	October November December

Employment Tax Periods

You must use the calendar quarter for withheld income tax and social security tax, and the calendar year for Federal unemployment tax

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APPENDIX K—MISCELLANEOUS

Baruch College
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New York
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DEPARTMENT OF ACCOUNTANCY

July 6, 1976

Honorable Lee Metcalf
The United States Senate
Washington, D.C. 20510

Dear Senator Metcalf:

In my previous writings, especially Unaccountable Accounting and More Debits Than Credits, I made reference to situations where various agencies of our Government, either individually or acting in concert, had failed to alert the public timely to the serious fiscal problems and accounting aberrations which prevailed for a particular industry or a particular major corporation. Thus, even when the agency or agencies knew, or should have known, of the festering conditions in the accountings for banks and stock brokerage firms, or those of the conglomerates, land developers, franchisors, real estate investment trusts, land developers, computer and peripheral equipment lessors, et al., neither the Securities and Exchange Commission nor any other regulatory agency deemed it necessary to "sound the tocsin." This condition, involving both the Securities and Exchange Commission and the Interstate Commerce Commission, surfaced dramatically with the collapse of the Penn Central complex. Subsequent to the denouement there were recriminations, Congressional inquiries, and some movement to tidy things up -- but then a calm would prevail until the next crisis.

It is with this condition as background that I write presently to point up what I deem to be a failure on the part of the Securities and Exchange Commission and the General Accounting Office to fulfill their respective roles insofar as the Lockheed Aircraft Corporation accountings and fiscal affairs are concerned.

I took the occasion of my testimony before the Subcommittee on Oversight and Investigation of the House of Representatives Committee on Interstate and Foreign Commerce on May 21 to set forth my serious criticisms of Lockheed's accountings as I had analyzed them as of the time of my testimony. Included herewith please find a copy of the text of my prepared statement; pages 32-36 are especially relevant.

Your attention is respectfully directed to my condemnation of the accounting for a sum in excess of a half-billion dollars as a so-called current asset as of the close of 1974 when, in fact, the sum thus shown was anything but current and, in my view, an asset only if an absurdity can be thus characterized. The SEC was undoubtedly aware of this accounting abomination but yet did nothing to compel a fair presentation.

The testimony before the Congressional committee also commented critically on the failure of the Comptroller General of the United States to point up in his testimony and reports to the Congress that a contemplated refinancing plan involving an ostensible transfer from liabilities to preferred stock of up to $200 million was little more than a cosmetic procedure, essentially devoid of substance. A copy of the most recent report of the Comptroller General, the one with which I thus took issue, is also enclosed. (*).

In short, here are two vital agencies of our Government principally charged with assuring full and fair disclosure, full and fair visibility and accountability, going along with Lockheed's pretenses and posturing.

It may well be that for political or other reasons our Government should be constrained to permit Lockheed to remain viable. Nevertheless, I maintain that this objective should be pursued openly and forthrightly, without subverting such agencies as the SEC and the GAO. If such agencies, presumed to be committed to the aforementioned standards of visibility and accountability, are shown to be mere extensions of our political process cynicism and lack of confidence in both our governmental structure and private structure will ensue. As I sought to emphasize in my testimony Lockheed suggests to me a parallel with the Watergate Syndrome.

As noted above my testimony was predicated on materials analyzed by me up to that time. Subsequently I have studied Lockheed's 1975 annual report form 10-K filed with the Securities and Exchange Commission. Included herewith are the auditor's footnotes numbered 2 and the Report of Certified Public Accountants. (*)

When developing the 1975 accounts Lockheed sought to recognize the tenuous quality of this ostensible asset. Thus, the company moved this enormous amount from the current assets down to the deferred charges cateogry of the balance sheet. It also asserted that this blob would be amortized at the annual rate of $50 million.

(*) Retained in committee files. The January 30, 1976 GAO report is entitled "Implementation of Emergency Loan Guarantee Act".

You will note the serious and grievous misgivings which the CPAs expressed in the footnote reproduced herewith; these were so serious as to compel a so-called "qualified opinion" i.e., as evidenced by the "subject to" assertions in the report, or"certificate" as it is referred to euphemistically.

I maintain, consistent with my previous assertions, that the residual asset of over $500 million is an "asset of the absurd" -- and it is no less absurd for being stepped down from current assets to the deferred charge category. I maintain once again that to permit the carrying of such a specious $502.5 million as an asset in the face of but $75.3 million in shareholders' equity is to perpetuate a canard.

I also maintain that Arthur Young & Company, the company's independent certified public accountants, cannot exculpate themselves by the qualified "subject to" phraseology. The item in question is so material, the reduction to any present realizable value so drastic , as to destroy any semblance of substance to the company's balance sheet. The fair presentation (conceivably at variance from what the auditors might rationalize as being "fair in accordance with generally accepted accounting principles") would demand that the $502.5 million be exorcised from the company's balance sheet -- then let the public and the Government make their independent judgments.

I am also enclosing for your consideration pages numbered 5, 6 and 7 from the 1975 form 10-K. These pages describe the refinancing contemplated by Lockheed. You will note that at the second and third lines of page 6 the company does give a nod towards fair disclosure by including the phrase "with mandatory redemption provisions." Alas, even this nod towards the whole truth is absent in Lockheed's description of the preferred stock contemplated under Phase III of the refinancing plan.

Most critically, I maintain that the section at page 7 entitled "Effect on Shareholder Equity" is specious for the reasons described in my May 21 testimony and noted above.

While the company may have been desirous of engaging in pretenses I fail to comprehend the reasons why the Comptroller General of the United States, in his aforementioned report to the Congress, failed to describe the contemplated preferred stock for what it was, i.e., nought but disguised debt.

I grant that earlier last month the company abandoned the Phase III program and is seeking to restructure its debt otherwise. (Is it conceivable that my exposure of this refinancing ploy may have contributed to the change?) What is important for present

purposes is that the true implications of the previously contemplated refinancing were not spread clearly and openly on the record for the government and the public generally to reach their ultimate judgments.

In closing, this is not a polemic against Arthur Young & Company; instead it is intended to ask the question why, in the first instance, did not the Securities and Exchange Commission insist that a major accounting firm like Arthur Young follow standards of reporting oriented towards full and fair presentation -- standards presumed to be implemented by the SEC ? And then the question is asked, as it was in my testimony of May 21, as to why the General Accounting Office has not been more forthright in its analyses and commentaries on the accountings by Lockheed when reporting to the Congress of the United States pursuant to the special mandate contained in the Emergency Loan Guarantee Act.

Should you require anything further in this connection please do not hesitate to call on me.

With highest personal regards,

Cordially,

Abraham J. Briloff

Abraham J. Briloff
Professor of Accountancy

AJB/jat

Enclosures

THE ESTABLISHMENT AND IMPLEMENTATION OF ACCOUNTING STANDARDS

STATEMENT BY

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Before

Subcommittee on Oversight and Investigation
Committee on Interstate and Foreign Commerce
U.S. House of Representatives
Washington, D.C.
May 21, 1976

Congressman Moss, Members of the Subcommittee on Oversight and Investigation of the Committee on Interstate and Foreign Commerce of the Congress of the United States, I am indeed privileged to share with you my considered views regarding the establishment and implementation of standards of accountancy. As the statement of issues makes clear accounting standards is generally subdivided between the standards pertaining to our underlying body of knowledge, our generally accepted accounting principles, hence, our "GAAP," and the standards governing the conduct of the accounting profession's principal responsibility, that of the independent audit of corporate enterprise, the profession's generally accepted auditing standards, or "GAAS." There are a number of collateral and subsidiary problems relating to this GAAP/GAAS syndrome which will be considered in the course of my remarks.

First as to GAAP. At the threshold I introduce the cartoon from The New Yorker magazine with the sardonic legend, "In examining our books, Mr. Mathews promises to use generally accepted accounting principles, if you know what I mean."

That jibe is the graphic equivalent of the words of a couple of political scientists, writing about the global reach of multinational corporations: "Skilled obfuscation is now an essential accounting tool . . . to create a tidy world for investors, regulatory agencies, and tax collectors . . ." This world "may have little or no resemblance to ... the real world ..." Accountants are described

as "hired miracle workers," rewarded by a market for "financial alchemy," "obsessed more with paper representations than with real things."

The condemnation, in words or pictures, puts in question the viability of the accounting profession and the validity of its very special body of knowledge, namely, generally accepted accounting principles.

Why all this obloquy? What is this elusive GAAP? Why is it beyond the comprehension of almost all mortals (accountants included)? Who, if anyone, possesses this esoteric body of knowledge?

Accountants use that term of art as though they knew what they were talking about, as though they were dealing with a body of principles; the truth is that they are confronting a chimera. In fact, many knowledgeable and sophisticated persons urge that we scrap the P in GAAP and substitute for it the letter S, for Standards. The cynic might well reply that whether it's GAAP or GAAS, it's still the same old gas. And the cynic might be more nearly right than we like to fancy, especially when we reflect on all the injustices perpetrated in the name of the Good Book of GAAP. There are those who suggest that the appropriate acronym should be derived from Cleverly Rigged Accounting Ploys.

Cynicism aside, what is this codification of the accounting profession's derived wisdom? Who has determined it and set it down? How authoritative is it? How effective is it in practice? Who will judge this effectiveness? What happens to those who violate or deviate from its precepts? All of these

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are very fine questions; many other appropriate questions might be posed by those given to exegetic analysis. But if you're seeking answers, you'll have to look elsewhere than in the accounting literature - and even then, I will not promise that you will discover an appropriate answer. You will find flip, generalized responses in textbooks (otherwise the professors would not use the text, and the authors would not earn royalties). You will find the reference to GAAP in every accountant's certificate, the nihil obstat for the published financial statements with which you are undoubtedly familiar (and which we will be considering presently at some length). But when it comes to a definition of terms, so that there can be effective communication from the statements' preparers to users, things get fuzzy.

Of many learned treatises regarding the origins of the elusive and illusory GAAP, the most succinct was presented in the Report of the Study on Establishment of Accounting Principles (i.e., by the prestigious Wheat Committee, named for its chairman, former Securities and Exchange Commissioner Francis M. Wheat).

> ... We must go back to the year 1932 when the accounting profession in the United States took a major step toward improving standards of financial accounting for publicly held corporate enterprises. On September 22 of that year, a date which has been described as perhaps the most important in the recent history of accounting, a committee of the American Institute of Accountants (the predecessor body of the American Institute of Certified Public Accountants), headed by the late George O. May, recommended to the New York Stock Exchange that audit certificates for

> listed companies should state that the financial statements were prepared in accordance with "accepted principles of accounting" and recommended five basic principles to be followed in the preparation of such financial statements.
>
> Less than two years after the report of the May Committee, Congress adopted the first of the Federal Securities Acts, an event which heralded a period of great expansion for the accounting profession in America.

The passage of these securities acts produced a field of creative tension between the newly created Securities and Exchange Commission and the accounting profession: Which of these sectors, public or private, would assume the primary responsibility of establishing the body of accounting principles? Former SEC Commissioner A.A. Sommer, Jr., alluded to this controversy: "The issue reached a culmination in 1938 when the Commission voted ... (to) accept for filing financial statements prepared in accordance with principles of accounting for which there was 'substantial authoritative support' " unless the Commission had theretofore decreed otherwise in its official releases. This was a 3 to 2 victory for the supremacy of the profession. The minority demurred, according to Commissioner Sommer:

> Two of the Commissioners favored the Commission adopting the role of final and complete arbiter with regard to accounting principles and urged upon their fellows that the Commission exercise to the fullest the power which Congress had given it. In the eyes of some commentators, this decision represented a gross and unwholesome abdication by the Commission of a responsibility which had been given it by Congress and in their eyes has been responsible for the confusions and difficulties which have ever since characterized the elaboration of accounting principles in the United States.

> On the other hand, it has been almost universally applauded by the accounting profession as an appropriate recognition of that profession's responsibility for the elaboration of accounting principles.

Mr. Sommer brought the tortured history of the formulation of GAAP down to the present:

> In 1940, the Committee on Accounting Procedure was established by the dominant organization of practitioners for the purpose of dealing authoritatively with accounting principles and practices. Its efforts over an 18-year period were primarily focused on the articulation of existing accounting practices and on pragmatic solutions to specific problems. Less concern was evidenced with the development of a coherent conceptual structure.
>
> In 1959, the American Institute of Certified Public Accountants ("AICPA") replaced it with the Accounting Principles Board ("APB") which endured until 1973. This effort was conceived as a dual one, including both the elaboration of a conceptual framework and the development of positions with regard to specific accounting principles and practices. Once again, despite expressed intentions and desires to the contrary, increasingly the emphasis was upon the pragmatic, and the conceptual effort took a secondary role. It became apparent that, difficult as was the development of positions on specific problems, agreement upon postulates and concepts was even more so. The pronouncements of the Board became increasingly lengthy, detailed and subject to controversy. All the while the research effort lagged woefully, with often many years expiring between the time a research project was authorized and commenced and its completion. The result was that the Accounting Principles Board Opinions became less and less animated by theoretical concepts and more and more by the pragmatic necessities of gaining a two-thirds majority of the Board. The Board, incidentally, was dominated by practicing accountants, with a smattering of financial executives, analysts and academicians.

The Commissioner then described the Board's disintegration over the merger accounting craze of the sixties leading to demands for its replacement by "a more effective instrumentality for the establishment of accounting principles..."

In his analysis of the history of the APB and its predecessor, the Committee on Accounting Procedure ("CAP") of the AICPA, Professor Maurice Moonitz (who had been the Director of Research for the APB) asserted that the evidence supports the following conclusions:

1. Neither the Committee on Accounting Procedure nor the Accounting Principles Board issued a binding statement of accounting principles in over thirty years of continuous activity in the area.

2. Neither agency adopted a set of terms with related definitions, e.g., "cost," "asset," "revenue." This is not surprising, since usable terminology and related definitions are part of a basic framework of some sort. Useful definitions cannot be framed in vacuo.

3. Practice followed APB recommendations closely and quickly with respect to the form of financial reports.

4. APB opinions expressing principles affecting the amount of periodic net income are relatively few. Their quality is spotty. Their impact on practice is uneven.

5. When opinions expressing principles affecting the amount of periodic net income received acceptance in practice, they were preceded by research studies published and widely distributed for an extended period before APB acted.

6. The buffeting the board took in its attempt to resolve difficult issues led it, in later years, to avoid them, and concentrate instead on compiling a record by issuing opinions on less controversial topics.

There were numerous voices which suggested that the efforts made to establish accounting principles in the private sector had failed and that the responsibility should now be assigned to the SEC or some new governmental agency. The AICPA responded to these criticisms and established the Wheat Committee. That Committee's recommendations were implemented with expedition: The seven-member Financial Accounting Standards Board ("FASB") was created with its hierarchy of a Financial Accounting Standards Foundation (to raise the funds to pay the very substantial FASB salaries and the expenses of running this new experiment in establishing principles).

Will FASB succeed where other attempts to effectively set accounting principles have failed? According to Moonitz, "The history of the numerous attempts to set standards ... tells us that the Achilles heel of the FASB is its reliance on voluntary cooperation." Such reliance, he says, is "illusory." Accordingly, "The key agencies to watch are the SEC and the Cost Accounting Standards Board. As long as both of them cooperate fully and completely the FASB will prosper. But, as soon as one of them should undercut it, the new standards board will replicate the history of the (CAP and APB)... Standing alone the FASB cannot succeed."

That Professor Moonitz's dismal prophecy may be coming to pass might be discerned from the jeremiads in an address by FASB's Chairman, Marshall Armstrong, early this year, before the Securities Regulation Institute, thus:

As we solicit views through our discussion memoranda and exposure drafts, we hear from many. A few, like the large public accounting firms and some business enterprises, are, for the most part, interested in achieving standards that will eliminate alternative practices, standards that will find their support in the broad, conceptual bases of accounting. Their responses reflect this, and while their views are diverse, their reasoning is generally quite lucid. And others --many others -- respond from a vested interest in diversity of practice, from a firm commitment to flexibility of measurement.

These latter reason awkwardly, for their motives --- though frequently well concealed -- lack purity, lack objectivity. In reflecting upon the views that we hear expressed by our public, I am reminded of the words of Edmund Burke, from Reflections on the Revolution in France. He said:

> Because half-a-dozen grasshoppers under a fern make the field ring with their important chink, whilst thousands of great cattle repose beneath the shadow of the British oak, chew the cud and are silent, pray do not imagine that those who make the noise are the only inhabitants of the field; .....

I am inclined to Burke's view; for in many of the problems with which we at the Board are dealing, we are faced with a small but vocal minority, whose primary concern appears not to be with the development of sound standards, but rather with the protection of their own domains. And, we must constantly remind ourselves of this, least we lose an awareness that this is the environment in which we are operating.

Apparently the heat is on Mr. Armstrong and on his colleagues. While sympathizing with his plight I believe his adoption of Burke's metaphor to have

been most unfortunate. While granting his disdain for the noisy grasshoppers, take note of his implied identification of the Financial Accounting Standards Board with the "great cattle (reposing) under the shadow of the British oak (chewing) the cud and are silent."

It is, in fact, precisely because I believe the Board to be happily chewing its cud and finding much comfort in the shade of the oak (albeit of the Nutmeg State rather than British) that I have despaired at the Board's accomplishments.

I have observed the ways in which it has avoided the critical issues, vacillated on other controversial matters, and handed out special dispensations in order to obtain a consensus for a particular standard. I expected much, much more from a select body endowed with presumptive independence and supposedly possessed of intellectual might, integrity and intrepidity. In short, we have had a surfeit of compromise, of the vulgar pragmatism, of pussy-footing and inching along, if we are to overcome the prevailing crisis in confidence in corporate accountability.

The flabbiness and flexibility in GAAP can and has been commented upon extensively in numerous texts and treatises of various kinds, including my Unaccountable Accounting and More Debits Than Credits; I shall for present purposes catalogue and exemplify this flap-in-GAAP, thus:

1. Problems in Revenue Recognition:

At the outset it should be recognized that the center of gravity of present-day accountancy is the statement of periodic (generally the annual) income of the entity. Income, in turn, represents the difference between the revenues attributed to the period and the costs attributed to that period. These revenues represent the gross inflow into the enterprise as a consequence of its activities; accordingly, it becomes necessary to understand the underlying field rules for the recognition and reflection of these gross inflows.

In October, 1970, the Accounting Principles Board promulgated a "statement" (rather than an opinion) Number 4, entitled "Basic Concepts and Principles Underlying Financial Statements of Business Enterprises." That statement described the revenue fountainhead as follows:

> Revenue is conventionally recognized at a specific point in the process of a business enterprise, usually when assets are sold or services are rendered. This conventional recognition is the basis of the pervasive measurement principle known as realization.
>
> Realization. Revenue is generally recognized when both of the following conditions are met: (1) the earning process is complete or virtually complete, and (2) an exchange has taken place.
>
> The exchange required by the realization principle determines both the time at which to recognize revenue and the amount at which to record it. Revenue from sales of products is recognized

under this principle at the date of sale, usually interpreted to mean the date of delivery to customers.

The realization principle requires that revenue be earned before it is recorded. This requirement usually causes no problems because the earning process is usually complete or nearly complete by the time of the required exchange. The requirement that revenue be earned becomes important, however, if money is received or amounts are billed in advance of the delivery of goods or rendering of services.

While the concept is reasonably forthright requiring the earning process to be complete (or nearly complete) and for an arm's length exchange to have taken place, the archives of accounting demonology are filled with instances of front-end-loading of revenues and the resultant income. (Front-end-loading is a term of art indicating that the amounts are being reflected on the income statements before they have been really earned.)

Thus, we have the sad sagas of:

a. The recreational land developers -- those who were selling land still under water or, alternatively, in the midst of the desert where waters will never come. These entrepreneurs would pursue their hard-sell techniques to obtain customers to sign up for plots at prices appreciably above the cost to the developer, paying minimal sums at signing with the remainder attenuated over a period of a decade or longer. The unpaid balance was not a direct liability of the purchaser; he may have had the right to rescind; the plot was probably in an undeliverable state and would remain so for many years to come.

Logically, one might say that neither of the preconditions to revenue recognition was met (i.e., completion of the earnings process and a bona fide exchange). Nevertheless, these enterprising entrepreneurs (with a nod from their auditors) found ways and put the putative sales and resultant enormous income on their books.

b. In other situations, best epitomized by the Penn Central, Commonwealth United, Bernard Cornfeld

and his Investors Overseas Funds, U.S. Financial, *et al.*, the corporations pretended to sell off substantial tracts of land and/or other real property at ostensibly huge profits. As it turned out the transactions were fake and hardly worth the paper on which the specious contracts were written. Nevertheless, the transactions went through the revenue accounts and the gains on the bottom line. The auditors were either oblivious of the circumstances of the sale or else found some way of rationalizing the transactions as coming within the four corners of GAAP -- however contrived.

c. In Stirling Homex the firm figured that it was entitled to pick up revenues from modular home units which it fabricated in its factories at the time it completed such fabrication and shipped them to its hypothetical customer in Erewhon. The auditors permitted the credits to revenues and the debits to accounts receivable -- the two invariably balanced.

As it turned out the customers and the accounts receivable were all as fabricated as the prefabricated units.

d. In Four Seasons the revenue-fabrication process revolved around the percentage-of-completion accounting practices (whereby revenue and income are reflected *pari passu* with the incurrence of costs related to the long-term contract). Since the costs were here being fabricated the related percentage of profit was fake.

e. So it was with franchisors who were permitted to book income concurrently with the writing of a contract with an ostensibly independent franchisee calling for very substantial franchise fees payable in the future. These frachisee- corporations were generally only minimally capitalized and frequently owned by the principal shareholders of the franchisor-corporations.

Again, the auditors were oblivious of the fundamental economics of the transactions or, as was generally the case, just determined to retain their blissful ignorance.

f. Front-end-loading of revenues and income was perpetrated by Mattel, Inc. in its 1971 year through a "Bill and Hold" procedure. Thus, it got customers to go along with pretended purchases of Mattel's toys and games (its principal products) with the understanding the charade could be aborted at will.

Charade notwithstanding the numbers went into Mattel's books of account and into its revenues and bottom line. The auditors apparently never searched very hard to ascertain whether Mattel was playing the GAAP-game according to the rules -- the shareholders got "snowed."

g. Other games with corresponding objectives were being played out by computer leasing companies (e.g., Telex, Memorex, Measurex) --and getting themselves called "safe" by their respective auditor-umpires.

2. Problems in Accounting for Costs

Directing our attention to the cost vector in the Revenue-Cost calculus we can see two related facets, i.e., the recognition of the cost to begin with and its allocation to a particular period.

Insofar as the initial recognition is concerned it is customary to expect an overt transaction, i.e., an exchange between the subject entity and another entity. Some exceptions to this transaction rule might be the recording of the hypothetical cost for deferred income taxes or anticipating losses from phenomena which are still contingent.

Once a cost has been recognized it becomes necessary to determine whether it should be charged off to operations as a current period cost, or alternatively, picked up as an inventory item or capitalized as a long-term asset (land, plant, patents, goodwill, etc.).

Needless to say depending on how one sets up the experiment a different number will come out on the bottom line of the income statement, and the balance sheet will reflect a different configuration.

So it is that under the cost rubric we find such manifestations as:

a. Capitalization of interest expense attributable to properties under construction or otherwise anticipatory to their income production. In this regard the Securities and Exchange Commission found it necessary to promulgate an Accounting Series Release (Number 163) to impose a general freeze on the further adoption of this cost deferral (hence,

income inflating) practice.

b. Leases: Here the problem is rooted in the question as to whether a transaction is an operating or garden variety lease, or whether it is, to all intents and purposes the acquisition of the property, per se. The leading scholars of the accounting profession remind one of Omar Khayyam's lament:

> Myself when young did
> eagerly frequent
> Doctor and Saint, and
> heard great argument
> About it and about, and
> evermore
> Came out by the same door
> wherein I went

Because of the inaction on the part of the APB and FASB the SEC was finally moved to a mere homeopathic remediation in its Accounting Series Release 147. This requires some footnote disclosure of the full payout or capitalized leases but then leaves the investor with a do-it-yourself tool kit.

c. A similar hang-up confronting the accounting theologians pertains to the accounting for the cost of pensions, especially the portion thereof attributable to the employees' periods of service prior to the adoption of a plan by the company. At the time of the adoption of the Pension Reform Act of 1974 ("ERISA") there were all kinds of scary stories as to the enormous amounts of increased liabilities which would be required to be reflected on the balance sheets. But FASB laid that ghost to rest by saying it wasn't really necessary barring

certain remote contingencies.

(Incidentally, the accounting profession's gamesmanship in this regard is one-upped by the United States Treasury Department which somehow manages to keep off its books of account the trillions of dollars of unfunded liabilities which have vested under the Federal pension and social security statutes. But that's a completely different ball game.)

d. Research and development costs: Here reference is made to the Appendix where I have reproduced the segments from my More Debits Than Credits which pertain to Lockheed Aircraft Corporation. To my knowledge this relates to the most enormous write off which has occurred under this caption. As is emphasized therein I maintain that it was utterly outrageous accounting which permitted the deferral of these TriStar developmental costs to begin with. But then I'll have much more to say about this ill-fated venture presently.

e. Inventories: Here the questions might well be what should properly comprise the deferred inventory amounts (e.g., the amounts incorporated in Lockheed's TriStar inventories to be considered below) and then, more pervasively, which alternative as to the flow of inventory costs, last-in-first-out ("LIFO") or first-in-first-out ("FIFO") should be used.

While the General Motors Corporation got around to adopting the LIFO alternative this year, 1974 was the epidemic year for this switching.

Dramatically evidencing the implications of the change was the 1974 year-end accounting of SuCrest Corp.

Here is the way the auditors explained the inventory switch in Note 4 to the company's statements:

Inventories are stated by groups or classes of merchandise at the lower of cost or market. Prior to July 1, 1973, cost was determined substantially on the first-in, first-out (FIFO) basis and included certain inventories stated on the last-in, first-out (LIFO) basis. The Company adopted, effective for the year ended June 30, 1974, the LIFO method of determining cost of substantially all of the raw sugar component of its inventories other than those of a newly acquired subsidiary which did not begin operations during this fiscal year. The LIFO method has the effect of charging current costs against current revenues and tends to defer the inventory profit which results under the FIFO method during periods of steeply rising sugar prices, such as the fourth quarter of the fiscal year ended June 30, 1974. Had the Company not made the accounting change, inventories at June 30, 1974, would have been increased by $27,007,000 and net income of $5,917,000 would have been reported for the year ended June 30, 1974, summarized as follows:

Gross profit on sales	$28,558,000
Expenses and other deductions-net	17,121,000
Income before income taxes	11,437,000
Provision for Federal and Canadian, and state and local income taxes	5,520,000
Net income	$ 5,917,000
Net income per common share	$3.18

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The impact of this shift in inventory methods can be best discerned by comparing the reported earnings data with what they would have been absent the change, thus:

Gross Profit on Sales	$ 1,551,000	$28,558,000
Expenses and other deductions-net	17,180,000	17,121,000
Income (loss) before income taxes	(15,629,000)	11,437,000
Provision for (credit from) income taxes	(1,206,000)	5,520,000
Net income (loss)	($14,423,000)	$ 5,917,000
Net income (loss) per common share	($7.75)	$3.18

f. Depreciation, Depletion, Amortization. Again putting aside the question as to how the fixed asset costs are accumulated to begin with (e.g., lease vs. purchase, whether or not interest is capitalized) we have the question of the years to which the cost is to be attributed through the process of depreciation, depletion or amortization. Here we have all of the manifestations of a Donnybrook. On the one hand we have the standards set down by the Internal Revenue Service whereby, pursuant to its Asset Depreciation Range ("ADR") promulgations the depreciable assets are deemed to be almost ephemeral; when we look at the financial statements (those that go to the shareholders) the identical assets would appear to be close to indestructible. It is this condition which contributes so unfortunately to the esoteric phenomenon known as the deferred income tax (an accounting liability which is not a liability).

Then, too, pursuant to the Securities and Exchange Commission Accounting Series Release No. 190 the depreciation, etc., deduction will be extrapolated by reference to the replacement cost contrivance.

This recent SEC release was the subject of the colloquy reported by Barron's (April 12, 1976), and included herein as Appendix B (at pages 2-3).

g. The "full costing" vs. "successful effort" accounting alternatives:

There was a time in 1972 and into 1973 when the burning issue confronting mankind, it might appear from attending the meetings of the late

Accounting Principles Board, was to determine whether "full costing" should be "permitted to fly." (This is the term of art I learned from attending one such meeting where member after member would ask, "Should I vote my conscience or for that which 'will fly'?" I came away from that meeting wondering whether the acronym APB stood for Aeronautical Principles Board.)

That issue, we should know, revolved about the accounting by oil and gas producers for their exploratory and similar costs, particularly those related to the ventures which proved unproductive.

The kingmakers of the Financial Accounting Standards Foundation designated the required four practitioners and one academician for the seven-member Financial Accounting Standards Board; they then selected members who were at opposite poles of this issue: Arthur Litke of the Federal Power Commission, umbilically tied to the full-costing alternative; and Robert Mays of Exxon, a "successful effort" exponent.

Why the fuss? Briefly, the full-costing option permits a greater amount of costs to be capitalized presently, thereby reducing the current charges to income account, with a resultant plus to the bottom line. By way of an oversimplified example:

Assume that a petroleum producer in a given year spends $1 million in exploratory costs on each of five tracts, that two of these turn out to be productive, the others produce only salt water. The two productive sites are expected to produce 10 million units of oil, and 1 million such units are produced in the current year (and sold for $8 each).

The comparative arithmetic would be as follows:

	"Full Coster"	"Successful Effort"
Gross Revenues (1 million @ $8)	$8,000,000	$8,000,000
Costs:		
Write-off of dry-hole costs for 3 unproductive tracts	$ 0	$3,000,000
Depletion	500,000 (a)	200,000 (b)
Total Costs	$ 500,000	$3,200,000
Income	$7,500,000	$4,800,000

(a) Total capitalized costs ($5 million) divided by 10 million anticipated units equals a depletion charge of $.50 per unit. Hence, 1 million produced units at $.50 equals $500,000.

(b) Total capitalized costs ($2 million) divided by 10 million anticipated units equals a depletion charge of $.20 per unit. Hence, 1 million produced units at $.20 equals $200,000.

Financial analysts were up a tree trying to develop comparability between and among oil companies following divergent accounting methods. Each company had a vested interest in its particular method. And as we should know, when a major oil company has a vested interest in anything it will soon find allies (including even accountants) who will make certain these interests are not disturbed.

Word spread through the hallowed halls of the Accounting Principles Board that the Congress and various regulatory agencies would look askance at any

tampering with the status quo. And the APB responded with the utmost intrepidity - it tossed the issue into the lap of the FASB. There were those who predicted that this new board's survival would depend on how it would handle the full-costing controversy.

Fortunately for the FASB, OPEC came to its rescue and distracted the morbid monitors of this old issue; the oil companies' new embarrassment of riches confronted the industry with fresh challenges, e.g., how to factor into the current year's financial statements all kinds of reserves for contingencies and other future losses. The full-costing controversy did not get into the FASB agenda until late 1975.

That is the way accounting principles evolve, or fail to evolve.

Financial analysts have regularly appealed to the accounting profession to provide them with the data based on both alternatives so that the efficient (sic!) market could be more so. Similarly, the Congress has indicated a need for a conversion to a single standard to permit a better determination of profit margins on a comparable basis. The response has regularly been, "we can't." That this is really the rationalization of a "we won't" can be evidenced by the Texaco tale of 1975.

Thus, in that year the corporation determined to switch from full costing to successful effort. And as might be expected its independent auditors were able to recast the company's data not only for the year 1975 but was able to do so right back to genesis. Thus, the 1975 form 10-K filed with the SEC shows fully recast data from 1974, 1973, 1972, and 1971;

further, the auditors were entirely capable of calculating the divergence of the cumulative impact for the years through 1970.

Significantly, the most traumatic effect of the switch appears to have been to decrease the carrying value of Texaco's Properties as of the end of 1974 by something over one billion dollars (from $9,593 to $8,563 million).

Insofar as the impact on 1974 is concerned the auditors calculated the net-after-tax effect of the switch to be a decrease in the amount of $46,624,000 -- hence, something around $90 million on a gross basis.

The point is that the auditors are entirely capable of manifesting a "can-do" attitude -- providing, of course, their clients are desirous of such an extension.

Interestingly, the auditors not only certified to the correctness of the new numbers for all of the five years prior to 1975 but they even asserted that they explicitly concur in the change in accounting method. I find this especially intriguing since this same accounting firm is the staunch defender of the full-costing method when it comes to others among their clients, e.g., Occidental Petroleum, which prefer that more flamboyant accounting practice.

h. Pooling-of-interests vs. purchase accounting: The reports of committees of the Congress studying the merger movement of the 1960s and resultant monopolistic practices are replete

with extensive discourse on the ways in which "dirty pooling" and/or "polluted purchase" accounting have been applied to make corporate earnings appear to be drastically at variance from reality. These two alternatives are still being utilized for the earnings-distortion process; that the problem is still acute is demonstrated by another lament by Mr. Marshall Armstrong in the course of the speech alluded to earlier, thus:

> A controversy began brewing in the late 60s, as financial writers recognized that the criteria for distinguishing between "purchases" and "poolings" had all but disappeared. Again, I might add, this occurred with the tacit agreement of the Securities and Exchange Commission. The APB placed the question on its agenda and strove admirably to obtain the two-thirds majority necessary to repair this decimated area of accounting; but it was possible to obtain the requisite consensus only by separating the business combination question from the goodwill controversy, and the result was two "cookbook" solutions, Opinions 16 and 17. The SEC, which had vacillated on the issue, finally accepted the Board's conclusions; and the major stock exchanges wrote letters to each of their listed companies urging support of these Opinions. These two Opinions -- the "cut and paste" product of one of the great political wars of American accounting -- had, in the view of many, more to do with the demise of the APB than any other action which it took. Not surprisingly, while the Opinions have been helpful, the solutions have not stood up; and the issues are again before us and are on the agenda of the FASB.

I, of course, share Mr. Armstrong's agony. Nevertheless, I cannot avoid wondering why he didn't speak out during the year 1968-1969 when the APB

was going about writing the cookbook, cutting and pasting. Be it remembered that he was then the vice president of the American Institute of Certified Public Accountants, destined to become its president. Nor did he speak out the following year when he attained the apogee of the Institute's hierarchy -- that, again let it be remembered, was the year when the two maligned opinions were put into effect.

Again, I concur with the incumbent FASB chairman in his indictment but then ask, where was he when the battle was raging? In any event, he attained the presidency of the AICPA and then the chairmanship of the FASB.

Generally Accepted Auditing Standards

Turning to the generally accepted auditing standards dimension of the GAAP-GAAS dichotomy, we find them enshrined in a compendium promulgated by the American Institute of Certified Public Accountants entitled Statements on Auditing Standards. Included therein are these principal categories (the prefixing numbers are those used in the compilation):

100 - Introductory
110 - Responsibilities and functions of the Independent Auditor
200 - General Standards of the Auditors
300 - Standards of Field Work
410 - Adherence to GAAP
420 - Consistency of Application of GAAP
430 - Adequacy of Information Disclosure
500 - The Fourth Standard -- that of Reporting

At first blush we might be led to go along with Professor Maurice Moonitz's view that auditing standards, unlike accounting principles are insulated from outside pressures. He would have us believe that the general standards, the standards of field work, and the standards of reporting have gained such universal acceptance that they could be presumed to be firmly established.

It may well be that the words are writ large and firm. As long as they remain as enshrined platitudes no one would or could argue with their validity. It is when the standards become operational that they began to bend, stretch, shrink--- and sometimes wilt.

Thus, I maintain that a fair and just application of standard qua standards of auditing would

have aborted the contrived transactions involving real estate, franchisors and equipment leasing, for example; if the standards were applied as standards there would not have been the erosion of the business combinations precepts -- the erosion which fueled the conglomerate craze and fooled multitudes of investors. There would never have been the ficti-tious ebullience manifested by the financial reports of our real estate investment trusts, land developers, bank holding companies --- among others.

If auditors had, in fact, recognized the significance of the term standards in the phrase auditing standards there would never have been the proliferation of litigation against the leaders of our profession for their dismal performance of the attest function.

No, I am not now alluding to those relatively infrequent cases where the auditors were sandbagged or snowed by a well-conceived and equally well-concealed fraud. Instead, I am here inveighing against those situations where the audit partners recognized that they were taking what they thought were calculated risks in choosing evil; they then lament the fact that they miscalculated their recogni-zed risks.

Specifically, I maintain that the accounting profession itself is confused as to what it is saying, and the responsibility it is assuming, when the accountants certify that the statements are supposed to be fair in accordance with GAAP. I am now zeroing in on the accountant's assertion of "fairness."

The AICPA in 1964 appointed a Special Select

Committee on Opinions of the Accounting Principles Board. The so-called Seidman Committee, chaired by an erstwhile president of the AICPA, J.S. Seidman, rendered its report in 1965, asserting unequivocally:

> The focus of accounting principles is on their application to financial statements. The focus of the auditor is on his opinion regarding the financial statements. What purposes and limitations attach to financial statements and to the auditor's opinion? This question is of first importance to the public and the profession. Literature abounds on it, but the answer is cast in many different molds. Until the profession has an official utterance about it, there is no point in beginning.
>
> The Committee believes that such an utterance should be given top priority. It would be the subsoil on which subsequent pronouncements could be grounded and understood.
>
> ...(I)n the standard report of the auditor, he generally says that financial statements "present fairly" in conformity with generally accepted accounting principles. What does the auditor mean by the quoted words? Is he saying: (1) that the statements are fair <u>and</u> in accordance with generally accepted accounting principles; or (2) that they are fair <u>because</u> they are in accordance with generally accepted accounting principles; or (3) that they are fair only <u>to the extent</u> that generally accepted accounting principles are fair; or (4) that whatever the generally accepted accounting principles may be, the <u>presentation</u> of them is fair?

For a decade the accounting profession treated the Select Committee's urgent plea with benign neglect. In the meantime accountants were shaken by guilty verdicts against them in the Continental Vending and National Student Marketing fiascos; they were the

subject of obloquy in the Penn Central and other civil actions -- all revolving about the question as to whether it is sufficient for statements to be merely GAAP-fair or whether they must, in fact, be inherently fair as the independent auditor sees the fair.

At long last, in July, 1975, the American Institute of Certified Public Accountants did manifest its formal interest in this fairness issue; its Auditing Standards Executive Committee promulgated Statement on Auditing Standards # 5 on "...The Meaning of 'Present Fairly' in Conformity with Generally Accepted Accounting Principles in the Independent Auditor's Report." In nine numbered paragraphs the statement considered the background of the Committee's promulgation, and the important implications of GAAP. In paragraph 4 the Committee set down its idea of fairness:

> (a) the accounting principles selected and applied have general acceptance ...;
>
> (b) the ... principles are appropriate in the circumstances...;
>
> (c) the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation...;
>
> (d) the information presented in the financial statements is classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed...;
>
> (e) the financial statements reflect the underlying events and transactions ... within a range of acceptable limits, that is, limits that are reasonable and practicable to attain in financial statements ...

Considering the awesomeness of the problem with which it was wrestling, could any set of standards be more pusillanimous than the foregoing? Where do we find a mandate to the auditor to determine and apply the fairest of the alternative GAAPs which may be available in the particular circumstances? Where is the auditor exhorted to ferret out those "events and transactions" which might be contrived, designed by management to produce a particular appearance, and to make abundantly clear that these events and transactions are to be given only limited significance by the users of the statements? What, if anything, in these five standards suggests a new, better doctrine? Will the Committee now constitute a new subcommittee to consider how wide is the "range" suggested by criterion (e)?

Granted paragraph 7 does counsel the auditors that "GAAP recognize(s) the importance of recording transactions in accordance with their substance," and that "the auditor should consider whether the substance of transactions differs materially from their form." But even on this self-evident assertion the Committee saw fit to introduce an equivocating footnote directing the reader to Statement on Auditing Standards No.1, section 110.02 which contains this resounding coda: "The statements remain the representations of management."

Does the Executive Committee expect that the pronouncement will bridge the gap in credibility, and raise the level of confidence in the auditor's

output? If it really is of this view, then, as in so many other instances, those who would beguile are the most deceived.

The Lockheed Syndrome

"The Watergate Syndrome" is generally recognized as the euphemism for the convergence of sinister forces from the political and corporate sectors, with the principal impact on the former. For me, "The Lockheed Syndrome" represents a corresponding confluence, but where the primary impact would appear to be on the latter.

The Lockheed Syndrome: Included herein as Appendix B are the segments of my More Debits Than Credits which pertain to the accounting practices of the Lockheed Aircraft Corporation.

That writing (essentially in the summer of 1975) concluded that an asset included among Lockheed's December 31, 1974 current assets (i.e., as part of its Inventories) in the amount of $558 million was overstated by $229 million (at page 148 of the Appendix). Subsequent disclosures by the corporation (especially in the form 8-K filed with the SEC for March, 1976) lead me to conclude that the $558 million was entirely unwarranted -- hence, the overstatement of the 1974 current assets amounted to $558 million rather than the mere $229 million toted up by me.

Be it noted that the item thus included as an asset comprised costs incurred on it L-1011, TriStar program, as follows:

Unrecouped production costs of previously delivered aircraft	$375 million
Unrecouped costs of initial planning and tooling	183 million
A total of	$558 million

The company (with the knowledge and consent of its auditors) had maintained that this current asset would be recouped out of the sale and delivery of 203 TriStar planes over the years 1975-1983. As it turned out, even as seen from the vantage point of December 31, 1974, there was neither an economic nor moral justification for deferring any portion of these costs. Thus, the company was then and there experiencing a negative contribution to margin from each of the planes it was selling and delivering; accordingly, at such a negative rate of recoupment the $558 million could never be realized upon. But yet the company's management and its auditors proceeded with the charade.

The March, 1976, form 8-K makes important mention of this enormous specious asset and determined that "commencing with the fourth quarter of 1975 (it would) amortize such costs to earnings through 1985 ..." Consequently, it was charging this fourth quarter with $12.5 million, one-fourth of the $50 million to be charged annually. (Note: The company uses a starting point for the amortization of $515 million rather than the $538 million used by me in my calculations.)

As a further nod towards "going straight" Lockheed advises that it would "reclassify the (remaining) $502.5 million of TriStar initial planning and tooling and unrecovered production costs from a current asset to a deferred charge on the year-end balance sheet."

This is nought but the perpetuation of a

canard; and there isn't even a hint of a mea culpa from management for having perpetrated this hoax in the first instance.

It should be noted that if Lockheed had, in fact, determined to wash out this grotesque asset from its balance sheet (please note that a deferred charge counts as an asset on the balance sheet) its shareholders equity, which amounted to $75.3 million at the close of 1975 would have been completely vitiated and in its place there would be shown an actual deficit in shareholders' equity in the magnitude of $300 million (even after giving Lockheed credit for the tax-effect of the writeoff).

That Lockheed's management was thus reluctant to face facts squarely is rationalizable, even if not pardonable. Less comprehensible is the independent auditor's going along with the hoax through 1974 at least (the 1975 audit is not yet available). Further beyond my comprehension is the apparent willingness of Felix Rohatyn, the stern judge of accounting gimmickry by the City of New York, should be willing to be associated with Lockheed's financial representations in his endeavors to effect a recapitalization for the company.

But beyond management, its auditors and financial consultants I cannot comprehend the attitude of the Securities and Exchange Commission in all this. Why the Commission is, to all intents and purposes, rolling over and playing dead in all this is completely beyond me. Let it also be remembered that the SEC was cuckolded by the same company on its C-5A accountings.

But ultimately I fail to comprehend the attitude of the Comptroller General of the United States in all this. As the accounting arm of the Congress he might well be expected to point out forthrightly, and if necessary in strident terms, that the Lockheed books were not fully and fairly reflecting its economic circumstances. Yes, there were hints that the company's projections were unduly optimistic and one might even infer hints of impending disaster but yet he permitted (and from all indications still is permitting) the Titanic to proceed on its course.

The Comptroller General's most recent report on the "Implementation of Emergency Loan Guarantee Act: Lockheed Aircraft Corporation Emergency Loan Guarantee Board, January 30, 1976" devotes several pages to the long-contemplated refinancing whereby it is hoped that $200 million in debt ($75 million to banks, $125 million to bondholders) would be transmuted into new issues of preferred stock. Despite that lengthy exposition the Comptroller General fails to observe that the preferred stock to be issued would be nought but debenture bonds in disguise. Thus, the sinking funds and mandatory redemptions provided by the refinancing plan convert the shares into debt instruments with but one possible difference. Thus, the year-to-year avails to be derived as dividends by the banks and any other corporate owners of the preferred stock would be insulated from Federal income taxes to the extent of 85 percent. Should not the Comptroller General have emphasized these critical facts when developing his aforementioned report, or when testifying, as he

did on February 19, before a committee of the Senate of the United States on that report?

Ultimately, too, we must ask whether the Secretary of the Treasury, the Chairman of the Federal Reserve System and the Chairman of the Securities and Exchange Commission had collectively discharged their responsibilities as monitors of the Lockheed Aircraft Corporation Emergency Loan Guarantee Bond.

In short, I see in the Lockheed syndrome the same violation of the Jeffersonian injunction which we discerned in the Watergate counterpart, thus, we permitted the eye of vigilance to be closed.

Calling Accountants to Account

Having thus far considered the standards promulgated by the accounting profession to govern its practices and, to a lesser degree those promulgated by the Securies and Exchange Commission impacting on the accountants' underlying body of knowledge, I turn to consider briefly the responses from the profession and the SEC where there has been evidence of serious aberrations in practice.

As to the accounting profession's self-regulatory endeavors, I have made it one of my responsibilities to monitor the AICPAs' disciplinary practices. The Institute does have a highly structured ethics apparatus, including a Professional Ethics Executive Committee and its subcommittees, the Professional Ethics Division with a staff, Trial Boards and sub-boards.

What has this elaborate disciplinary machinery achieved? Its box score for the six-year period of 1970 through 1975, with the following results:

For conviction of bribery	16
For failure to file (or for false filing) of personal returns	13
Because of revocation of member's certificate by his state-licensing body	15
For conviction of grand larceny, embezzlement extortion, theft, and corresponding high crimes	7
For failing to disclose (or for false disclosure) to the SEC or IRS	6
For conviction of mail fraud	5
For lack of independence	4
For moral turpitude and other undisclosed crimes	4
For solicitation and advertising	3
For violation of securities laws	2
For fraud on CPA exams	1

For failure to pay for securities	1
For obstructing justice	1
For failure to acquire sufficient information	1
For filing false reports with HUD	1
For inadequate disclosure in footnotes	1
For substandard auditing	1
A total of	82

These are all grievous offenses, but with the possible exceptions of actions taken against those convicted in the Continental Vending and National Student Marketing criminal cases the list of disciplinary action is oblivious of the egregious violations of our profession's commitment to a moral and ethical code which I have included in what I characterize as our profession's Roll of Dishonor -- a roster running the alphabetical gamut from A through Y, from Ampex through Yale Express.

This analysis leads to the conclusion that the AICPA Ethics Division can be seen as doing a remarkably fine job in following the judgments of the courts, so that where the CPA has been convicted of a felony the Institute responds. By my simplistic standards such a procedure requires neither an Ethics Division and its attendant apparatus, nor even a Code of Ethics. Thus, every mortal is required to adhere to the laws to which he is subject; if being law-abiding is to be the ethical measure then the AICPA need but employ a mail clerk to receive copies of the judicial judgments. As I see it, the standard of professional persons (CPAs included) should be <u>higher</u> than the law (but certainly <u>not above</u> the law).

The Securities and Exchange Commission has, in a number of Accounting Series Releases,publicized consent decrees obtained against accountants, including a few against major accounting firms (e.g., Number 153 against Touche, Ross in connection with its U.S. Financial audit and the historic No. 173 against, Peat, Marwick, Mitchell & Co. in re: Penn Central, Stirling Homex, National Student Marketing, Republic National Life Insurance Co., Talley Industries). While recognizing the significance of the obloquy thus imposed on the firms the resultant penalties were not symmetrical with those imposed by the Commission on less visible (and omnipotent) professionals found out in serious misdeeds. This has induced a certain cynicism on the part of the observers of the disciplinary practices pursued by the Commission.

The courts had been an effective ally of those of us who hoped for higher standards of performance by the accounting profession in its fulfillment of the most important attest function, especially when it involved the audit of publicly-held corporations. It is in this area of service where the profession is most directly fulfilling its professional responsibility as the historian in the economic microcosm. It is undoubtedly for this dimension of service, the fulfillment of his responsibility to the world of "third parties" that the accountant is best entitled to the status and stature of a professional -- and to derive the material and psychic compensations appropriate to such a calling.

These legal actions, generally brought on a

class-action basis under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)-5 of the SEC's regulations thereunder, have certainly compelled the profession to recognize a higher standard of responsibility than that which the profession was willing to undertake on its own initiative.

But this hope for upward mobility has been seriously set back, even if not aborted, by the decision of the Supreme Court of the United States in Ernst & Ernst v. Hochfelder (decided March 30, 1976). The majority opinion of the Court stated the issue at the very outset, thus (it should be noted that Ernst & Ernst, the auditors, were the defendant-petitioners; Hochfelder the euchred plaintiff-respondent):

> The issue in this case is whether an action for civil damages may be under § 10(b) of the Securities Exchange Act of 1934 ... and Securities and Exchange Commission Rule 10(b)-5... in the absence of an allegation of intent to deceive, manipulate, or defraud on the part of the defendant. (Emphasis mine)

After an exhaustive analysis of the semantics of the 1934 congressional enactment the Court decreed that "...the language of §10 (b)... clearly connotes intentional misconduct..." (emphasis supplied). So it is that no allegation having been made that Ernst & Ernst were actual accomplices of the actual perpetrator of the fraud against Hochfelder, et al, they were exculpated. Thus, the language of the decision would appear to require a direct conspiratorial involvement on the part of the auditors to support an action under Rule 10(b)-5. The majority's

decision was put into clear perspective by the opening gambit of a sharply-worded dissent by Mr. Justice Blackmun, thus:

> Once again... the Court interprets §10(b) ... restrictively and narrowly and thereby stultifies recovery for the victim. This time the Court does so by confining the statute and the Rule to situations where the defendant has "scienter," that is, the "intent to deceive, manipulate, or defraud." Sheer negligence, the Court says, is not within the reach of the statute and the Rule, and was not contemplated when the great reforms of 1933, 1934, and 1942 were effectuated by Congress and the Commission.

Mr. Justice Blackmun's dissent includes an almost impassioned plea for holding the auditors responsible for their apparently conceded negligence, pointing up the critical role played by the auditor accountants in the securities arena.

Nevertheless, the Court has decreed that negligence by a professional person is not sufficient to hold him liable to those who were victimized by his negligence even though the person professes competence, expertise and responsiblity (and where he is paid on the basis of such professions).

For me this very pretentious profession is the perpetration of fraud if it is known that negligence is a hidden factor in the profession's tool box.

To make matters even more confusing at present there are those legal experts who are even asserting that even negligence would not support an action against an auditor under 10(b).

By *Hochfelder* the Court has reversed the process of the accountant's responsibility in securities matters by two score years. In a *Yale Law Journal* article, December, 1933, Mr. Justice William O. Douglas (then a professor at Yale) and George E. Bates commented on the impact of the developing securities legislation on accountants. They took careful note of Mr. Justice Cardozo's 1931 decision in the *Ultramares v. Touche* case, where he asserted that negligence, *per se*, would not support an action by third parties; instead, he decreed a standard of *gross* negligence (hence, constructive fraud). The Douglas-Bates article asserted:

> To say the least the Act goes as far in protection of purchasers of securities as plaintiff in *Ultramares Corp. v. Touche* unsuccessfully urged the New York Court of Appeals to go in the protection of a creditor. The charge which that court thought so "revolutionary" as to be "wrought by legislation" has been made. And the duty placed on experts such as accountants has not been measured by the expert's relation to his employer but by his service to the investor.

The authors went on to observe that this burden may be so onerous as to discourage"reputable and substantial persons" to be named as experts. "Nevertheless," they continued, "it may be predicted - that the fees of these experts will measurably increase..." Most assuredly the accountants' fees have increased measurably (and even more than measurably) during these two-score years. But the Court has now put the investors back into the box in square one, at least insofar as their relying on the auditors' professed expertise under the 1934 Act.

Quo Vadis?

We are left, then, with what is undoubtedly the most vital segment of my responsibility in appearing before this Committee today, to respond to Quo Vadis?

First, and in a general sense, it behooves our society to comprehend that our major corporations, individually and most certainly collectively, represent enormous aggregates of resources --human and resources. But concurrent with these enormous concentrations of resources, per se, these enterprises represent aggregations of power -- power over the economic, social, political and environmental destinies of the total society -- and on a universal scale.

Because our Founding Fathers recognized the truth implicit in Lord Acton's dictum they built into our governmental fabric the constitutional process of checks and balances -- to assure that the power delegated to others shall be exercised with visibility and accountability. As a consequence, it was anticipated there would be a lesser likelihood that the power would corrupt absolutely, and that the delegated power would be used and not abused.

In the corporate context, as I have noted at a number of points heretofore, I look to the independent auditor-accountants to assure to the total society the visibility and accountability regarding corporate management's exercise of its enormous power. In turn, the various regulatory agencies established by our laws, as well as the judiciary and the executive branches of our government are constrained to oversee this entire

complex process of interwoven responsibilities, checks and balances -- all to assure that the enormous corporate resources and power are being exercised to achieve the greatest good for the greatest number.

Specifically, what do I propose?

First, I propose a major restructuring of the disciplinary process within the accounting profession itself. Thus, the oligopolistic stranglehold by the Big Eight* firms over the American Institute of CPAs must be broken in the profession's disciplinary and self-regulatory proceedings. To remedy this condition I urge the establishment of an independent disciplinary apparatus, adequately funded and fully staffed. Such an independent board would be expected to take notice, either on its own initiative or by referral from members of the profession or others, of deviations from the established standards of conduct. I would expect such a board to proceed with its inquiry and judgment independent of (and probably also in advance of) any other proceedings before the courts and/or regulatory agencies.

I maintain that all of the arguments advanced by the Wheat Committee report leading to the establishment of an independent, broadly constituted board for the advancement of principles of <u>accounting</u> are appropriate with even greater import for the advancement of the principles of the <u>accountant</u>.

How such a professional integrity board would be constituted and financed I leave to further deliberation; I would not necessarily adopt the

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*Arthur Andersen, Coopers & Lybrand, Ernst & Ernst, Haskins & Sells, Peat, Marwick, Mitchell, Price Waterhouse, Touche Ross, Arthur Young

FinancialAccounting Standards Board as my standard for excellence in this regard. While that board is independent on paper, its principal reliance on the profession's oligopoly for funding and other support subject it to pressures corresponding to those on the AICPA, and the erstwhile APB.

As for the Securities and Exchange Commission, I would urge that it move more aggressively on at least three fronts relating to the role of the auditor-accountants. First, consistent with the preceding recommendation I urge that the SEC use its disciplinary procedures more aggressively, more even-handedly and more openly. Thus, the Commission does have its Section 2(e) procedures and it does apply them on rare occasion. Nevertheless, the causes célèbres comprising my Roll of Dishonor have not brought forth the suspensions from practice before the Commission of the individual perpetrators thereof even where the firms may have suffered a mild rebuke under the respective consent decrees. Thus, I ask the Commission to review its findings in Accounting Series Releases 153 (Touche Ross), 157 (Arthur Andersen), 173 (Peat, Marwick) to point up clearly and overtly who it was that fouled the accounting nest so grievously.

Second, I urge that the SEC use its legislated authority to establish and implement standards of accounting and for accountants. Thus, where it is determined that the profession has not moved effectively, then let the Commission direct the standard to be applied -- if the auditor prefers

not to follow such standard then let him take exception, spell out the reasons why, and provide the supplemental data to permit a translation from one set of assumptions to another. (it should be noted that the SEC may not always act with wisdom corresponding to mine (e.g., in connection with replacement cost), but yet, the Commission does afford an opportunity for a free and open dialogue -- like the one being held here today.

Third, I would urge that the SEC mandate that the independent auditor's certificate be interpreted to mean that the auditor, on the basis of his professional responsibility and capability asserts that the statements are as fair as he sees the fair and that in his view the alternatives selected from the spectrum of GAAP are those which (again, in his judgment) are most conducive to the fair.

In short, I am asking the SEC to interpose its authority to put an end to the equivocation on the part of the accounting profession regarding the meaning of its universally used, and oft-abused phrase "present fairly."

In the light of the Supreme Court's decision in Hochfelder I believe it essential for the Congress to act promptly to make clear that its 1933 and 1934 enactments intended all professions bearing upon the issuance or trading of securities be held to a high standard of responsibility consistent with the public's needs in this vital area. And the accountant, for example, should be inculpated where he performed his taks in a manner inconsistent with

the standards presumed of him -- and it should not matter whether such failure be the result of negligence or calculated deception should not matter in a civil proceeding though it should be controlling in a criminal case. This legislation is necessary to reverse the caveat emptor dictate of the Court; it is needed to make meaningful the truism expressed by Circuit Judge Henry J. Friendly (CCA-2), thus, "In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar." This should be read in tandem with Mr. Justice Blackmun's observation in his Hochfelder dissent, thus:

> It seems to me ... that an investor can be victimized just as much by negligent conduct as by positive deception, and that it is not logical to drive a wedge between the two, saying that Congress clearly intended the one but certainly not the other.

As the Justice concluded:

> Once again it rests with Congress to rephrase and to re-enact,if investor victims, such as these, are ever to have relief under the federal securities laws that I thought had been enacted for their broad, needed and deserved benefit.

This urgent plea is made not to add to the burdens of the auditor accountants; instead the sole objective is to assure the viability of accountants as a responsible profession in the public securities arena. I predict that absent such protection of the public against professional negligence and irresponsibility

the public will soon reject the accountant's certificate as a shibboleth and either eschew the securities markets or else insist that a new, responsible, calling be introduced to write the corporate history as the surrogate for all of society.

Finally, I propose the establishment by Congress of a Corporate Accountability Commission. Such a commission's mandate would include the responsibility for studying, determining, and promulgating standards pertaining to corporate morality, antitrust and monopoly aspects, accounting accountability, and corporate tax policy - all this on a national and multinational scale.

Coming within the ambit of such a commission would be the coordination and possibly even the overseeing of functions presently housed in the Securities and Exchange Commission, Federal Trade Commission, General Accounting Office, agencies responsible for a particular industry or nexus of industries (Interstate Commerce Commission, Federal Communications Commission, Federal Power Commission, Civil Aeronautics Board, Cost Accounting Standards Board, and even the Comptroller of the Currency and the Federal Deposit Insurance Corporation). The Internal Revenue Service might be included to the extent that its functions impact upon or relate directly to the principal responsibilities of such a Corporate Accountability Commission.

Why such an overarching body? The modern corporation is no longer a corner drug store. Nor is the typical corporation which we have been considering capable of being pigeon-holed into a single area of activity, and thereby capable of

being understood in its entirety by any particular industry-oriented agency. Even the seemingly ubiquitous SEC finds itself stymied when it is confronted with an inherently moral and behavioral question regarding corporate slush funds used for bribing governmental leaders and personnel - directly or through political contributions. Similarly, the SEC has confessed to some impotence when dealing with bank holding companies (alleging that the Federal Reserve, Comptroller of the Currency, and Federal Deposit Insurance Corporation have interposed their authority), or with a Penn Central (because of the ICC's primacy in this area).

It is not that I am necessarily concerned about any resultant loss of efficiency or duplication of effort which may result from the prevailing proliferation of agencies and commissions. Instead, experience informs me that the real truths and the effective responses in behalf of our total economic, capitalistic, competitive society might well "fall through the cracks."

In addition to acting as an administrative coordinating agency, I would look to such a Corporate Accountability Commission to establish procedures for disciplining and even ostracizing persons identified with any of the professions charges with a public responsibility coming within the purview of the commission's charter. Such professions would, of course, include lawyers and accountants as well as those underwriting or dealing with corporate securities. Conceivably, appraisers and actuaries could be

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subsumed among these professions. But in addition I would look to such a commission to professionalize corporate managements and directors, and thereby discipline or remove from any corporate responsibility those who may have violated the established standards of conduct appropriate for their positions.

I would then expect this commission to monitor the effectiveness of the disciplinary and self-regulatory procedures being applied by the various professions relating to corporate accountability which are presumed to be capable of self-discipline and regulation. It may even be that the role of such a commission would embrace a judicial function. Such an extension might take the form of a "Trade Court".

The Corporate Accountability Commission as contemplated by me would also be responsible for liaison with the Congress. Even with limited experience one can discern a proliferation of overlapping and duplicatory inquiries by Congressional committees and subcommittees, frequently involving themselves in calling the same persons from within and without government to testify regarding a particular problem. Similarly, the commission would maintain liaison with the European Economic Commission in order to coordinate developing practices of the Common Market (and similar blocs) with those of United States based entities.

Further, I would expect that this body would also serve as something of a "distant early warning system." Thus, when it discerns a burgeoning trnd in corporate organization and function, whether it be in the multinational or multioperational sphere

or otherwise, I would expect the commission to describe promptly and in detail just what it sees and foresees. Thus, I want to avoid the discovery too late for prophylactic procedures the consequences of tomorrow's counterpart to the REITs, bank holding companies and other conglomerates, and multinationals (with their enormous power exercised insidiously, frequently producing insidious corruption).

This is, I admit, a most ambitious agenda which I have placed before this Committee. Regrettably these parlous and perilous times prevent a more sanguine response to the problems embraced thereby.

Mr. Chairman and Members of the Committee, I sincerely appreciate the important opportunity you have thus afforded to me to express my concerns and proposals for change. I should be pleased to respond to any questions you might care to direct to me.

(Excerpt from Professor Briloff's book "More Debits Than Credits.")

October, 1974, brought forth the first substantive pronouncement from the Financial Accounting Standards Board (designated Statement No. 2), "Accounting for Research and Development Costs." The implications of this promulgation can best be judged by examining the accounting practices in this regard by the highly controversial Lockheed Aircraft Corporation; in fact this particular FASB statement might well be dubbed the "Lockheed Salvation."

Jogging back in time, in September, 1965, the company entered on its ill-fated C-5A venture, culminating in the fiasco aptly described as the "C-5A Scandal," to be rescued from devastation by a United States government bailout in a number of ways, including a $250 million bank loan guaranteed by the Emergency Loan Guarantee Board, a Federal agency.

No sooner did Lockheed appear to have been saved from the C-5A tailspin than it was caught up with the L-1011 (TriStar) Airbus program, for which Rolls Royce was supposed to develop and produce the engines. Rolls Royce went into bankruptcy, though the TriStar engine program seems to have survived, thanks to an intervention by the British government (after some prodding by ours). When writing *Unaccountable Accounting* in late 1971 I observed (thereby reflecting a serious myopia): "I am not aware of any particular [accounting] aberrations insofar as the Rolls Royce-TriStar crisis is concerned. . . ." The whole world is now aware of the most serious aberrations, both in the airbus program itself as well as in the company's accountings therefor. It is, in fact, this very program which produced another most serious financial crisis at Lockheed at the advent of 1974.

So serious was the impact of the company's airbus involvement

that Arthur Young & Company, its auditors, was constrained to qualify its 1973 certificate, stating that the company's statements were fairly presented ". . . subject to the realization of the L-1011 TriStar inventories . . ." What was there about these inventories which could have given pause to the auditors? The footnotes provided some important insights into this massive L-1011 cost build-up, thus:

A total of 56 L-1011 TriStar commercial jet transports have been delivered through 1973. Backlog at year-end included 73 firm unfilled orders and 70 second buy orders. Second buy orders have minimal down payments that are retained by the Company if the order is canceled by the buyer.

Inventories applied to the TriStar are as follows (in millions) [comparative data for December 31, 1972 have been deleted in this presentation]:

	December 30, 1973
Development cost	418
Initial tooling and other nonrecurring costs	293
Production costs	1,882
Total incurred inventory cost to date	2,593
Total cost of sales to date	1,097
Gross inventories	1,496

From these "gross inventories" there was deducted the amounts of customers' deposits; these amounts do not affect the asset carrying value of the program in process.

It should be noted that these TriStar inventories comprised almost 75 percent of all of Lockheed's inventories at the end of 1973, and then equaled five times the company's entire net worth.

The auditors' disclosures in the footnotes notwithstanding, one might seriously question whether this cost build-up was warranted in view of the history of disappointment with the TriStar's progress almost from its inception. Thus, tracking the successive Reports to the Congress by the Comptroller General of the United States, who

was charged with that responsibility as an incident to the "Implementation of the Emergency Loan Guarantee Act," we read:

From his Initial Report (December 1972):

Lockheed currently estimates that it will have to sell about 275 TriStars to recover all program costs. As of October 31, 1972, Lockheed received firm orders for 117 TriStars and purchase options for an additional 67. Deliveries to the airlines began in April 1972.

Until recently Lockheed had been estimating a break-even point of from 255 to 265 L-1011 sales. Current production costs, however, have been higher than projected . . . This has resulted in the currently estimated break-even point of 275 aircraft and increased borrowing requirements.

* * *

The estimate of possible losses on the sales of 110 or 170 TriStars has excluded several factors which are not susceptible to measurement in advance. A further production stretchout, for instance, could increase costs significantly. Also, commitments to subcontractors for aircraft components in excess of those needed for aircraft sold may have to be fulfilled, regardless of production cutbacks . . .

* * *

L-1011 program expenditures and current projected costs are substantially higher than were originally anticipated. The company stated that costs significantly increased following a production stretchout after the 1971 disruption resulting from the Rolls-Royce financial failure . . . Furthermore, prior cost forecasts were based on a projected learning rate which did not materialize.

The Comptroller General's Third Report to the Congress (April 1974) was especially caustic, thus:

Our prior report [Aug. 13, 1973] indicated that Lockheed was restructuring production processes to reduce costs and improve the delivery schedule of its L-1011 commercial aircraft [TriStar] and that new top management personnel had been designated to monitor the progress of the TriStar program. Nevertheless, costs of producing each succeeding aircraft have not decreased as forecast. In addition, reductions in deliveries scheduled and anticipated during 1974 and 1975 have decreased the company's expected sales revenues and have re-

quired Lockheed to stretch out production of the aircraft. . . .

These circumstances have resulted in a revision of Lockheed's financial forecast. *Experience has shown that prior forecasts of L-1011 costs were optimistic* . . . [emphasis supplied].

Should not Lockheed's independent auditors have taken cognizance of the condition alluded to by the Comptroller General that: "Experience has shown that prior forecasts of L-1011 costs were optimistic"? Should not this very optimism have prompted them to assume the responsibility to eliminate from the inventory carrying value the amount required to bring the managerial optimism down to reality? Surely these auditors should have known that footnotes and "subject to" opinions should not be used to exculpate the auditors where they are aware of the defects inherent in the data per se.

So much for the Lockheed L-1011 history as it read as of the close of 1973. Remember how the inventory accounts showed "Development costs" of $418 million? Remember how that amount of costs (and undoubtedly other amounts included in the $1,496 million aggregate TriStar inventory) was the consequence of cost overruns and overly optimistic projections? Of course, such a cost build-up carries with it a day of reckoning since it will ultimately have to be charged against future revenues, thereby serving to reduce future profits *pro tanto*. But this, dear reader, is to ignore the alchemy of the Financial Accounting Standards Board, Lockheed's fairy godmother. Thus, in its October 1974 statement the FASB decreed (paragraph 12) that "all research and developments costs encompassed by this statement shall be charged to expense when incurred." But that was not what produced Lockheed's golden coach; it was paragraph number 15 which did that trick.

Thus, the Board also decreed that any R & D amounts which had been accumulated through 1973 should not be charged against subsequent earnings, as might have been the case by applying APB Opinion 20; instead, the costs theretofore capitalized "shall be applied retroactively by prior period adjustment." FASB justified this determination in paragraph 63:

The Board considered three alternative approaches to reporting a change in the method of accounting for research and development costs: (1) prior period adjustment, (2) the "cumulative effect" method described in APB Opinion No. 20. "Accounting Changes," and (3) continued amortization of previously capitalized costs. The Board concluded that the prior period adjustment method will provide the most useful information about research and development costs for comparing financial data for periods after the effective date of this Statement with data presented for earlier periods.

As a consequence the $418 million of TriStar R & D which had never been expensed on the reports prepared through 1973 never really got charged against earnings. The implications of this FASB ukase become apparent when we compare the gross TriStar inventory of $1,496 million as of December 30, 1973, as shown by the report for that year (as detailed on page 140) with the corresponding configuration as of the identical date as it appeared in the 1974 annual report, thus (in millions):

Production costs of undelivered aircraft	$ 384
Unrecovered production costs of delivered aircraft	362
Initial planning and tooling costs	183
Total work-in-process	$ 929
Materials and spare parts	66
Advances to subcontractors	44
Gross inventories	$1,039

So it is that an inventory as of a given date determined, verified and certified by the auditors to amount to $1,496 million as calculated in accordance with GAAP, becomes $1,039 million on that very same date, determined, verified and certified by the auditors to be in accordance with GAAP. (The purist might have noted that subtracting the R & D $418 million from the previously stated gross inventories of $1,496 would have left $1,078 million, rather than $1,039 million. There must have been another $39 million of

R & D lurking somewhere in the other numbers in the original compilation.)

ONCE IS NOT ENOUGH

As a consequence of the retroactive inventory adjustment Lockheed is absolved from having to charge off against its subsequent operations $457 million of TriStar costs. In short, to the extent of $280 million on an after-tax basis, two groups of shareholders are made to pay for the same earnings, to wit: Those who paid for them when buying the shares on the basis of the undiminished earnings through 1973 (since the costs were theretofore capitalized), and those who are buying the shares on the basis of the 1974 and subsequent reported earnings, which are not made to bear the brunt of the theretofore deferred costs.

Any reader who might still conceive of accountancy as a science or even an art with a modicum of precision might also want to look at the Capital section of Lockheed's balance sheets. Thus, the 1973 report disclosed a "Total stockholder's equity" as of December 30, 1973, in the amount of $283,211,000. If he were to turn to the balance sheet as of the identical date, but now as included in the 1974 report, he would find that the December 30, 1973, "Total shareholders equity" was a mere $3.3 million—an evaporation of $280 million.

The 1974 report does provide us with a footnote describing the circumstances of the change, thus:

Note 2 - Change in Accounting:

In accordance with a pronouncement of the Financial Accounting Standards Board, the Company revised its accounting policy in 1974 with respect to development costs related to specific production programs. The new policy provides that all such costs, other than those reimbursable under the terms of a contract, be charged to earnings as incurred. The only such costs affecting the accompanying consolidated financial statements relate to the TriStar program. Through 1973 development costs applicable to the TriStar program since its inception in 1968 previously had been included in inventory. Inventory is charged

to cost of sales as airplanes in the program are delivered. The consolidated financial statements have been restated to remove TriStar development costs from inventory ($487.8 million at December 30, 1973), and to charge such costs to earnings in the periods incurred. The amount of such costs charged to earnings in 1974 was $18 million. In connection with the change in accounting, gross profit on sales of TriStar aircraft and spare parts which previously had not been recognized, has been recorded retroactively on the basis described in Note 1d; also federal income taxes have been recomputed for the affected years. A reconciliation of net earnings (loss) with amounts previously reported for the four years ended December 30, 1973 follows (in millions of dollars):

	1973	*1972*	*1971*	*1970*
Net earnings (loss)—as previously reported	$ 16.8	$ 16.2	$ 15.4	$ (86.3)
Development costs incurred	(20.7)	(52.9)	(92.7)	(141.6)
Gross profit recognized	20.7	9.9	—	—
Related income tax effect	1.4	19.6	37.9	40.1
Net earnings (loss), as restated	$ 18.2	$ (7.2)	$(39.4)	$(187.8)

As a result of the change in accounting, consolidated retained earnings at December 31, 1972, has been reduced by $281 million.

Clearly, the decision to ban the further deferral of Research and Development costs may have merit, especially when one recognizes the evils or incongruities which had theretofore been perpetrated through the capitalization process. Certainly Lockheed's deferral practices were questionable, to say the least. Nevertheless, to permit this kind of absolution through the retroactive restatement directive is giving the perpetrators of the mischief a double benefit.

THE HARD QUESTIONS

But Lockheed's accountings for TriStar inventories raise additional serious problems—problems which are, if anything, more basic and general than those rooted in R & D.

First, it should be noted that the 1974 airbus inventory amounted to $987 million gross ($735 million after deducting $252 million in customers' advances). This amount was included in the company's balance sheet as a current asset, along with cash and receivables, thereby implying their realization within the next twelve month operating cycle. This implication is entirely unwarranted. Thus, the 1974 TriStar inventories include (in millions):

Unrecouped production costs of *delivered* aircraft	$375
Initial planning and tooling costs	183
A total of	$558

Only a most minor portion of that $558 million will be attributed to the TriStar aircraft to be delivered during 1975. This becomes apparent from the Lockheed form 10-K, telling us that "Studies indicate a TriStar program of 300 aircraft should recover the December 29, 1974, inventory and provide a gross profit. . . ." Of these programmed 300, i.e., the number required for recoupment plus a marginal gross profit, 97 had been delivered through 1974. Of the remaining 200 or so, "Deliveries in 1975 are expected to be in the range of 25 to 30; in subsequent years of the program annual production and deliveries are expected in the range of 12 to 24 aircraft." (During the first six months of 1975 only 11 TriStars were delivered.)

Clearly only 12 to 15 percent of these accumulated deferred charges of $558 million are expected to be incorporated under Lockheed's accounting system into the 1975 revenues cycle; accordingly, only that minor portion ($70 to $85 million out of the $558 million) warrants inclusion as a current asset, assuming the usual standard for that balance sheet segment.

If current assets mean assets which can be realized currently, then something like $470 to $480 million of Lockheed's inventories should be diverted to the other, non-current asset segment of its balance sheet.

But now let us go back to what management revealed in its 10-K, namely: "Deliveries in 1975 are expected to be in the range of 25 to 30; in subsequent years of the program annual production and deliveries are expected in the range of 12 to 24 aircraft." Taking the most optimistic scheduling, the $558 million in deferred costs will be allocated to the years when the remaining 203 (i.e., the 300 programmed less 97 delivered through 1974) planes are to be delivered, as follows:

Year	*Number of Aircraft*	*Percent*	*Allocated Amount (millions)*
1975	30*	15	$ 84
1976/1982	24 annually	12 annually	67 annually
1983	5	1	5
Totals	203	100	$558

* In view of the fact that only 11 were delivered during the first six months of 1975 this projection is undoubtedly optimistic.

So far so good—the arithmetic adds up nicely to the $558 million. But now let us reflect on some additional critical facts: The gross profit is expected to be marginal (it has averaged about a half million dollars per airbus through 1974), and even this marginal profit would be vitiated by the amounts which Lockheed would be constrained to spend on continuing R & D on this program. Consequently, these $558 million in deferred costs will be naught but recouped over the years through 1983 (and even then only if we assume management's expectations of 300 deliveries as well as its most optimistic delivery projections). Based on these assumptions I maintain that for Lockheed and its auditors to reflect on its 1974 balance sheet at full dollar-for-dollar value the numbers of dollars which are still way off in the future is a distortion of economic reality. Instead, I conclude that a more realistic economic evaluation of this $558 million as of the close of 1974, using a most reasonable 15 percent per annum discount factor, would be determined as follows:

Year	*Amount Expected to be Realized (millions)*	*Monthly Amount (col 2 ÷ 12) (millions)*	*Present Value Factor*	*Present Value Amount (millions)*
1975	$84	$7	11.08*	$ 77.6
1976 through 1982	$67 annually	5.6	51.82** multiplied by .86	249.9
1983	$ 5	5. (presumed to be January 1983)	.30***	1.5
Totals	$558			$329.0

* Represents present value of an annuity of $1 per period for 12 monthly periods at 1¼ percent per period (i.e., 15 percent ÷ 12).

** Represents present value of an annuity of $1 per period for 84 monthly periods (i.e., the number of months involved in the seven-year span 1976–1982) at 1¼ percent per period. This would commute the value to December 31, 1975; to discount that value to December 31, 1974, this factor must be multiplied by .86.

*** Represents present value of $1 due 96 months hence, discounted at 1¼ percent per month.

I therefore conclude that the inventory carrying value for the deferred charges subsumed in the TriStar inventories as of December 29, 1974, are excessively stated to the tune of $229 million ($558 minus $329 millions). These assumptions are not "guaranteed"; presumably the definitive data and sophisticated determinants regarding the scheduling are in the possession of the company and its auditors.

It should be noted in passing that this calculus is not unique. Thus, I have applied the same line of reasoning and figuring in my critical commentaries of the land developers and, as will be demonstrated in Chapter 6, in my indictment of Leasco's accountings for its computer portfolio.

But even subtracting the calculated $229 million from Lockheed's inventories would not, in my estimation, resolve all the questions regarding its accounting for the TriStar inventories. As the company's 10-K informs us, Lockheed is made to incur substantial costs for ongoing development as well as for general and administrative expenses directly attributable to this program. These

continuing costs aggregated $76 million during 1974 ($18 million for the development costs, $58 million for G & A); for 1973 the aggregate was $91 million ($21 million and $70 million for the two components respectively).

As a consequence of these charges the marginal gross profit booked by the company on this program (about a half million per plane, about 3 percent of the sales price) has been transmuted into a substantial loss. For example, despite a gross profit of $27 million booked in 1974 on the 49 planes delivered that year, the $76 million in these ongoing costs produced a loss on the program of $49 million. (For 1973 a $21 million gross profit on the 41 delivered L-1011s became a loss of $70 million.)

Now, then, according to the traditional wisdom of accountancy, inventories should not be carried forward on the balance sheet at an amount which is so high as to dictate that a loss will have to be sustained on their eventual liquidation. This is mandated by the clear-cut statement in Accounting Research Bulletin No. 43, Chapter 4 on "Inventory Pricing," to wit:

> . . . in accounting for inventories, a loss should be recognized whenever the utility of goods is impaired . . . The measurement of such losses is accomplished by applying the rule of pricing inventories at *cost or market whichever is lower* . . . As used in the phrase *lower of cost or market* . . . (1) Market should not exceed the net realizable value (i.e., estimated selling price in the ordinary course of business *less reasonably* predictable *costs of completion and disposal*) . . . [italics supplied].

If, then, Lockheed is destined to keep on incurring costs for R & D and administration of the L-1011 program as it continues to sell the aircraft at or about "break even," accounting wisdom dictates that in the valuation of the inventories in the pipeline the "reasonably predictable costs of . . . disposal" need to be factored in.

Assuming for present purposes that these ongoing costs will "level down" to but $5 million monthly or $60 million annually (as contrasted with the $91 and $76 million for the past two years), the present discounted value as of December 31, 1974, of

these costs anticipated for the 97 months required for the run-off of the program would amount to a staggering $280 million. (The present value of an annuity of $1 per month for 97 months discounted at 1¼ percent per month, hence 15 percent per annum, is given by the tables to be $56. Multiplying this factor by the presumed $5 million monthly expenses equals the $280 million sum.)

It is significant to note that these ongoing TriStar costs have not leveled down—at least not for the first half of 1975. Thus, Lockheed's six-month report informs us that the company lost $31 million on this program during this period. I infer from the report that while it may have had a gross profit of $6 million on the 11 planes delivered out it incurred applicable costs of $37 million—hence, very close to one-half of the $76 million for the preceding year.

The company's third quarter, 1975, report indicates that these ongoing costs have not abated. Thus, the TriStar program produced a $52 million loss for this period. Because of mounting uncertainties with the program Lockheed has aborted the accrual of any gross profit on the L-1011s; accordingly this $52 million loss must represent the G & A expenses, ongoing development expenses, and now "a $10 million provision for potential losses on aircraft that must be resold." Clearly, a $5 million monthly projection is a "conservative ballpark figure."

Putting all of these subtractions together I maintain that the gross 1974 TriStar inventories shown by the balance sheet at $987 million should be reduced by a ghastly $509 million (representing the $229 and $280 million adjustments); hence, the $987 million should be written down to $478 million. This severe abatement is deemed necessary because the company and its auditors failed to reflect two self-evident fundamental truths, to wit:

1. A dollar due in 1983, for example, is not properly to be reflected as an asset of $1 on the 1974 balance sheet.
2. If, to realize a dollar of 1974 inventory, 10 cents will have to be incurred on its disposition, that inventory should be marked down to no more than 90 cents.

I would, of course, give a compensatory credit of, say, $209 million to reflect the tax effect on the $509 million total adjust-

ment—but even a \$300 million subtraction from Lockheed's \$3.3 million in shareholders' equity would prove devastating. I cannot help but feel that Lockheed and its auditors recognized all that I discerned in this context—in fact I am certain that with their collective wisdom they saw much more, and saw it even more intimately and with greater circumspection. Nevertheless, recognizing the implications of a \$300 million net charge against a \$26.5 million net equity they determined to back away from the moment of truth—expecting, or at least hoping, that something will turn up. And if nothing should turn up they were confident that the full faith and credit of the United States Government, even more than the Financial Accounting Standards Board, would produce some new miracle so as to permit Lockheed to continue "to fly."

Lockheed and its auditors might argue that SEC-Accounting Series Release No. 164 (November 21, 1974) grants the dispensation to book and disclose the TriStar inventories in the form and manner set forth in the financial statements. True, that release does pertain to the disclosure patterns for receivables and inventories "related to defense and other long-term contract activities."

Unquestionably the TriStar program is such a "long-term contract activity." Nonetheless, I maintain that the ordinary field rules for such contracts "will not fly," given the circumstances which prevail for this company regarding this program.

Thus, given a company where liquidity is not an especially critical problem, the current-noncurrent distinction might well be deemed academic—so that dividing the inventories between the two categories would complicate the statements.

Further, where the long-term program is tried and tested and a significant profit potential is clearly indicated, the discounting process to determine the commuted value of the ultimate net revenues as of the balance sheet date might, again, be academic. Such a net value might well be expected to exceed the deferred inventory cost. Again, this is not the L-1011 case.

Finally, I could go along with the justification of the ASR 164 application if the number of planes required to absorb the cost were a reasonably firm projection. But my readings of the reports

of the Comptroller General of the United States regarding the 300-plane receding target makes of that number little more than pie in the sky—hence, another manifestation of the Talley hodgepodge.

But what if, the foregoing notwithstanding, the company's independent auditors could convince the Securities and Exchange Commission to concur in their collective wisdom? Well, I suppose this would not be the first time that the Commission was constrained to make an accounting determination predicated more on political pragmatism or expediency than on sound economics—sometimes even against its own better judgment (e.g., the investment credit, land developers' accountings, business combinations, reporting by diversified companies).

PROPOSED PLASTIC SURGERY

That the company knew better than I will ever know how tenuous was its 1974 balance sheet, and especially the shareholders' equity portion thereof, might be evidenced by the fact that it proceeded to perform some extraordinary surgery which, as will become evident, is naught but plastic—producing little more than a mere cosmetic effect.

This surgical procedure was described in a company press release which read as follows (because of its import I will not omit a single word even though a few may be extraneous for our purposes):

Lockheed, Banks Agree on
Financing, Recapitalization Plan

Burbank, Calif., May 9 [1975]—Lockheed Aircraft Corporation and its 24 lending banks announced today that they have reached tentative agreement on a two-phase financing and recapitalization program, subject to approval by the government's Emergency Loan Guarantee Board.

The first phase is expected to be implemented shortly. The second phase will require approval by Lockheed shareholders and holders of its subordinated debentures and is contemplated to be implemented during the third quarter of 1975.

When fully implemented, the plan will extend Lockheed bank financing to December 31, 1977, including extension of the government guarantee, provide a two-year interest rate reduction to 4 percent per annum on nonguaranteed bank borrowings, provide for the addition of $50 million to $75 million to Lockheed equity through conversion of bank debt and deferred interest to preferred stock, and provide for an offer to exchange Lockheed debentures for preferred stock.

"This plan is designed to provide adequate financing for all current programs and will provide the corporation with a more desirable equity base on which to build for the future," Daniel J. Haughton, Lockheed board chairman, said.

First Phase of Plan

In the first phase of the plan, the banks would extend to December 31, 1977 Lockheed's $650 million 1972 Credit Agreement, which is now due to expire on December 31, 1975. The government guarantee of up to $250 million borrowings under the 1971 Credit Agreement also would be extended to the end of 1977. The interest rate on nonguaranteed borrowings (currently $400 million but due to be reduced under the plan by conversion of some debt to preferred stock) under the 1971 Credit Agreement is to be reduced to 4 percent during the two years beginning April 1, 1975, returning thereafter to prime rate plus 1 percent.

At that time, Lockheed will issue to the banks ten-year warrants under which the holders may acquire up to 1.75 million shares of Lockheed common stock at $7 per share.

Lockheed's 1974 Credit and Security Agreement, which subject to certain conditions can provide up to $75 million of additional credit, and which currently expires December 31, 1975, also would be extended to December 31, 1977.

Second Phase of Plan

The second phase will require approval by Lockheed shareholders and debentureholders for new Series A Preferred Stock, to be issued to creditor banks in conversion of debt, and Series B Convertible Preferred Stock, to be offered in exchange for outstanding debentures.

Upon approval of the new issues, the banks will convert an initial $50 million—composed of $43 million in bank borrowings and $7

million of deferred interest—to Series A Preferred Stock. Lockheed at the same time will offer to exchange Series B Convertible Preferred Stock for its outstanding 4¼ percent Convertible Subordinated Debentures, up to the total issue of $125 million. In order to arrive at tentative terms for the proposed exchange offer, which will be based on market conditions at the time of the offer, the company and its investment bankers, Lazard Freres & Co., have had discussions with the principal holders of its subordinated debentures.

The exchange offer will be contingent upon a specified minimum amount of the debentures being exchanged for Series B Convertible Preferred. If holders of the specified minimum accept the exchange offer, the banks will convert up to an additional $25 million of Lockheed borrowings to Series A Preferred.

Upon the banks' conversion of $50 million in debt and deferred interest to Series A Preferred Stock, Lockheed would issue warrants to the banks under which the holders may acquire up to an additional 1.25 million shares of Lockheed common stock at $7 per share.

The foregoing reveals all the qualities of the handiwork of Felix Rohatyn (of Lazard Freres, Lockheed's financial adviser).

The especially interesting aspects revealed by the press release were:

1. The Government which was supposed to be off the hook long before this stays firmly hooked.
2. Lockheed's banks will get a "sweetener" in the form of options to buy 3 million Lockheed shares at $7.
3. Bringing together some of the numbers in the press release we can see that (assuming the debenture holders go along with a total conversion to the Preferred B shares) there would be (in millions):

Reductions in Liabilities:	
U.S. Guaranteed portion of bank debt	$ 43
Interest accruals	7
Other bank loans	25
4¼% Subordinated Convertible Debentures	125
Total	$200
Offset by increases in:	
Series A Preferred Stock	$ 75
Series B Preferred Stock	125
Total	$200

(And then there is the matter of the 3 million share call option to be accounted for.)

So far so good. But what the press release neglected to say was (and here we must consult the 10-K):

1. The dividend rate on the A Preferred to go to the banks will be $9.50 annually. Because of the fact that 85 percent of these dividends will be freed from tax such a dividend (assuming a 40 percent tax rate) is the equivalent of an interest rate of almost 15 percent. So that even without the 3 million share option given them as a "kicker," the banks will not be hurting. Reciprocally, a $9.50 dividend is, for Lockheed, the equivalent of a 16 percent interest rate.
2. But even more serious sins of omission committed by the creator of the press release were the following:
   a. The release did not disclose that the Series A Preferred requires a sinking fund commencing May 1, 1979, to redeem annually at least 10 percent of the shares originally issued.
   b. The release did not disclose that the Series B Preferred will require a sinking fund commencing in 1983 to redeem each year 10 percent of such preferred outstanding on October 1, 1983.

A $200 MILLION CHARADE IN THE OFFING

As a consequence of these sinking fund provisions I maintain that labeling of these preferred shares as anything but long-term debt would be a hoax. And if Lockheed's auditors should, in fact, go along with this ploy and show the $200 million of preferred stock as a part of the company's shareholders' equity I will pose the identical "$200 Million Question" to them that I did when exposing Leasco's corresponding charade. (For the details of this saga see Chapter 7.)

When will writers of press releases stop presuming that the public can be hoodwinked and cuckolded indefinitely? Hasn't Watergate taught them anything?

It should be noted in passing that this recapitalization could, if implemented, produce as much as $70 million in windfall bookkeeping income for the company. Thus, the $125 million in bonds

to be converted into the B Preferred Stock had an aggregate market value of about $55 million. For the reasons to be discussed in detail in Chapter 7 the spread ($125–$55 million) is credited to income (available as an offset against any special writeoffs Lockheed desires, or is compelled, to make.

As it turned out there are later developments which intensify these misgivings regarding the TriStar L-1011 inventory. In Chapter 2 I commented extensively on the testimony of Secretary of the Treasury Simon and Lockheed's Board Chairman Haughton before the Senate Banking Committee. From the record of the August 25 hearings it would appear that the success of the airbus program was predicated on Lockheed's system of bribes, kickbacks and other payoffs. If, then, this system is aborted, or, in the absence of such a critical change in policy, the Emergency Loan Guarantee Board refuses to "roll over" loan maturities, then it would follow that the 300-plane sales projection would collapse. In either case the realizable value of the enormous TriStar inventory would be made seriously contingent.

In view of the company's most flimsy equity position the financial statements created as of December 31, 1974 (with a certification updated as of May 20, 1975) become illusory insofar as their current reliability is concerned. This, then, should lead to Arthur Young & Company's rendering their certification inoperative—so as to prevent continuing reliance on its imprimatur. Mind you, it is my view that the auditors, presumed to have knowledge of the Securities and Exchange Commission inquiry prior to their updated certification on May 20, might well have withheld their approval thereof pending the clarification of the critical issues then in question. Be that as it may, certify they did; but then the mandate of Statement on Auditing Procedures No. 1, Section 561, is clear: Where the subsequently discovered facts seriously impair the continued reliability of the financial statements the auditor's opinion needs to be aborted, *nunc pro tunc*. (Remember Yale Express in Chapter 2.)

In closing this discourse on the effect of inventory taking and valuing on the balance sheet and income statement, it should be

noted that there is an important interrelationship between this segment and the revenue recognition process. This was especially evident in the tale of Stirling Homex (specious sales converted revenues into accounts receivable) and percentage-of-completion accounting (where the inventories are injected with a profit amount which has not been really realized).

Again, no facet of the accounting process is a world apart. In fact, this is the rundamental axiom of double-entry accounting: For every debit there is a corresponding credit. For every action there is an equal reaction (at least in quantitative terms).

Excerpts from Barron's Interview, 12 April 1976

No Last Trumpet

Abe Briloff Still Leads the Crusade for Honest Accounting

A VALUED contributor to this magazine since 1968, Abraham J. Briloff needs no introduction to readers of Barron's. Professor Briloff—he teaches at the Baruch College of the City University of New York—unquestionably has had a greater impact on accounting principles and practice in the past decade than any other individual. His fervent and unswerving personal and professional commitment to raising the standards of accounting has won him brickbats as well as bouquets from his colleagues—and the overwhelming gratitude of investors. Hard on the heels of publication of his latest book—"More Debits Than Credits" (Harper & Row) — Professor Briloff recently sat down with the editors of Barron's for a freewheeling discussion of accounting and related topics. The accompanying article is the first part of that interview.

— STEVEN S. ANREDER

ABE, what does a crusader do when he wins all his crusades?

A. I'm far from having won the crusades. To the contrary, there are times when I almost feel a sense of despair that the major objective is still so far from having been accomplished. I'm talking of developing a sense of continuing indignation as contrasted with just momentary indignation when a full-blown scandal erupts.

Q. But wouldn't you say that there has been some progress?

A. Yes, there has been some tightening. And there has been some tinkering with the accounting principles. But the essential process of gamesmanship with and within accounting still prevails when you read that the banks suddenly have gotten up-tight because the SEC is now going to demand that when they have swap transactions with their captive REITs they must recognize the loss; it's obvious we haven't come far enough.

One would have assumed, based upon ordinary, logical reasoning, that the loss would inexorably have been recognized when a bank picks up property worth $1 million in exchange for a loan on its books of $10 million. And one might have expected also a certain inexorability with respect to bank accounting when the banks were compelled to swap a $100-million New York City bond for a new bond worth $60 or $70 million. All of which is symptomatic that the important objectives are far from having been attained.

Q. So what you're really saying, then, is that the progress chiefly has been in the area of disclosure rather than in accounting?

A. Even in disclosure, though, progress has come only after problems have become aggravated and usually after the public has already discerned the nature of the problems. Remember, too, these disclosures—whether with respect to taxes or depreciation or leases—are in the footnotes. But

the public, I find, still concentrates on earnings per share.

* * *

Q. Are you suggesting that disclosure in itself is not a very powerful aid to the investor?

A. That's putting it very succinctly. Again, let me come back to the rather visible phenomena relating to banks, the New York City bond swap, on the one hand, and their dealings with the real estate investment trusts, on the other. I must assume that the sophisticated decision-maker in the marketplace can do his own arithmetic and determine with reasonably good results just what "haircut" ought to be taken with respect to these particular transactions. But the banks are not required to actually factor them into the accounting—either into the debits and credits, or into the bottom line.

Q. How do you answer this, Abe: the chairman of one major bank says that if we do make the banks account for these losses, that will stop the swaps dead in their tracks for a number of banks. He says he's concerned about the prospect of the accounting ruling interfering with swap programs, and he added that he can't see "any real social benefit" in the rules.

A. Of course, in terms of the social benefit, they're weeping lachrymosely because of the fact that the REITs will now be compelled to go into bankruptcy. Maybe this is what he meant about the anti-social implications.

* * *

Q. Abe, do you have any other quarrels with bank accounts?

A. Well, much as I try to understand the accounts of the bank holding companies—and I made this point before Senator Proxmire's committee, so it's in the public record — going through their prospectuses and their 10-Ks and the like, I found that I felt like poor Alice sinking deeper and deeper into the quagmire. The numbers they present fail to focus on the critical questions that are being asked.

Q. Can you be more specific?

A. Let's take a Citicorp, for which $1 billion is not a material sum. All it has to do is to indicate that it's got $1 billion invested in leveraged leases and leasing operations. Then it may, in one short paragraph, indicate that it is accounting for these on the financing lease basis and expect that you ought to be satisfied with this kiss-off. After all, $1 billion for Citicorp might be but 2% of their total resources.

Now, Citicorp is an important institution in the finance leasing business, buying its equipment and putting it out on lease under various circumstances, leveraged and otherwise. Yet to cover that particular activity, the company need only provide a few paragraphs. By contrast, competitors like Leasco and others are forced to split their gut to describe their accounting practices for an amount a hell of a lot less than $1 billion.

Q. Should there then be a new definition of materiality?

A. Yes. Not only material with respect to this particular enterprise but material also in terms of what their competitors are required to disclose given the same circumstances.

* * *

Q. Abe, to hark back to where we started this interview, if you haven't exactly won your crusades, can we expect to hear more from you on new areas of accounting controversies?

A. I think you can recognize the fact that I have not compromised with my principal responsibility of teaching. There also have been some continuing client responsibilities, and most of my writing efforts have been committed to getting "More Debits Than Credits" completed. But probably this summer, when commitments for seven or eight different talks between April and June have been fulfilled, I expect to go back to some of our old friends, the major conglomer-

ates. Without any prejudgment—and I say that sincerely—I want to see to what extent there have been improvements wrought in terms of their accounting mix.

Q. Can you provide us with an idea of what you'll be looking for?

A. My approach will be to review acquisitions they've been affecting and look at the principles of accounting they've been using. I will, in essence, look at the rhythm of their acquisitions.

Q. What will that tell you?

A. Whether they have been playing a rather intriguing game of possibly first picking up 18% or 19% of a corporation; then, after getting some degree of control, however subtle it might be, over that underlying company, causing some changes in accounting methods along the way. These don't factor into the investor corporation—they don't call it a parent corporation yet. But after having affected some of those changes, I'm interested in learning to what extent the new figures move into the accounting process of the conglomerates.

Q. What percent can you own without consolidating equity?

A. Consolidation requires over 50%, but the equity method generally dictates 20% or more.

Q. What happens after 20%?

A. After 20%, they have to pick up the proportionate share of income or losses of the underlying company.

Q. And under 20%?

A. Nothing. They just pick up dividends, if any.

* * *

Q. Abe, to switch gears here, what do you think about the trend towards replacement value depreciation?

A. For me, this is nothing more than a prelude to a rip-off of the federal tax revenues. As a matter of fact, its proponents have made no secret about it. We lose track of the fact that the SEC has indicated the reason that it's trying to relate depreciation to price levels and the like is that there are various studies and tax proposals to permit this added deduction. Last November, SEC Commissioner Loomis, when he addressed the New York State Society of CPAs, said to us, look, if you want your clients to get this added deduction for tax purposes, you better accept our program. And the Department of Commerce, through its Bureau of Economic Analysis, beginning with their January report, similarly adopted the replacement cost standard for purposes of determining depreciation in their GNP data.

Q. Apart from the fact that it's being pushed by the SEC, what's wrong with the idea, in view of all the fuss about underdepreciation?

A. To begin with, I'm not accepting the concept that there is underdepreciation. But then I want to invert the challenge. If the companies really feel that they are taking inadequate depreciation in their financial statements, I say to them, all right, by way of your demonstrating your good faith, put into the published financial statements the same number for depreciation that you're putting onto your tax return. This would then mean an enormous increase in the amount of depreciation being reported for financial statement purposes.

Q. Shouldn't you complete that phrase? Wouldn't it mean an enormous corresponding decrease in reported earnings?

A. Of course. Look at it this way: A few years back, U.S. Steel found that it was being severely threatened by the conglomerates as a potential target for a takeover. It realized that it had to boost reported earnings. What U.S. Steel did was to move away from its traditional depreciation practice, which corresponded with the accelerated depreciation methods for tax purposes, and moved into straight-line de-

preciation. The increase in that year's income, as I recall it, was $90-odd million. Now that's history.

But once U.S. Steel began to straight-line its depreciation, the company's income over the years has been substantially inflated. I received the 1975 U.S. Steel report a couple of weeks ago. Footnote number 10 carries the buildup of what it calls the deferred tax liability, representing the amount of taxes factored in as a minus on the income statement but which is not being paid out to the government currently. As an aside, I suppose one might say, one should live so long before they pay it. But when you look at footnote 10, you see that because of depreciation differentials alone, there is a deferred 1975 tax buildup of something like $93 million.

Q. You mean U.S. Steel is overstating its reported earnings by $93 million?

A. It's worse than that. It is overstating the amount of tax expense on its income statement in contrast with the amount of tax being reported to the government by $93 million. Remember, assuming a 40% tax rate, that $93 million represents about $230 million of a differential in the depreciation deduction. The point I'm making is that there's about $230 million of depreciation that is being claimed on the company's tax return over and above the depreciation that is shown in the financial statements.

Q. Abe, if tax depreciation accounting were applied to the U.S. Steel 1975 annual, what would be the effect on reported profit to stockholders?

A. My estimate is that there could be as much as a $230 million impact on a pretax basis and about $130 million at the bottom line—almost 25% of the reported amount. Incidentally, I use U.S. Steel because its report came to me a couple of weeks ago, and I immediately turned to it far more intensely than others because, if you recall, in my new book "More Debits Than Credits" I devoted an entire chapter to the U.S. Steel report. I just wanted to see whether there was anything in the '75 report which was critically at variance with the '74 annual that I had used as the frame of reference.

Anyway, when you look at U.S. Steel's depreciation for '75 in contrast with '74, there is a substantial reduction in depreciation. As I recall, U.S. Steel had a 10% reduction in revenues, but a 25% reduction in the amount of depreciation. I attribute that, in good measure, to the fact it is utilizing for the production of revenues in 1975 plant that has already been fully depreciated even on the company's books and long ago depreciated for tax purposes. If I were to move all of these data upwards to a replacement cost basis, thereby factoring in the inflationary impact, I can see where a number like a quarter of a billion, or even a third of a billion, might be in the ballpark for the additional depreciation cost.

Q. Which would be charged to income?

A. Yes, an additional charge. Mind you, I would then, of course, deduct a third of it as a tax. But if this were really factored into the finan-

cial statements, it could be by as much as a quarter of a billion dollars on a net after-tax basis. And so the phenomenon of depreciation and replacement cost is, of course, an important matter of concern at the present time.

* * *

Q. Your feeling, again, is that price level or replacement value depreciation would be merely a psychological prelude to some change in the depreciation schedules.

A. Yes, for tax purposes. I hear that the word from members of the House Ways and Means Committee is that they cannot change the effective rate of tax as shown by the tax code for corporations much below 48%. It would not be politically palatable. Thus, they're hitting on ways of "gimmicking it up."

Q. Let's get this straight, Abe. If this so-called reform went through, you're saying that companies would have it both ways, just as they have it both ways now. They would report huge depreciation for tax purposes and keep on telling stockholders they're making this much money, if not more than ever.

A. Yes. And even more. The so-called replacement depreciation would not even be factored into their income statement. It would, as now required by the SEC, merely show up in terms of a supplemental footnote.

Q. Isn't this bullish from an investor's standpoint, Abe, if this goes through?

A. Oh yes. My offhand hunch is that if you permit the accountants to fantasize with respect to replacement value of equipment, they'd cut the ultimate tax to zero.

Q. But as you said to start with, you really don't think then that in general the corporate plant is underdepreciated?

A. The point I am making is that the cost of replacement may be much greater than the historical cost of replacement, but the cost or the loss is not being sustained by the corporation. It is being borne principally by the government because of the investment credit and tax writeoffs, other major portions are being absorbed by the bondholders and other lenders, and the rest of it by consumers in the future.

Q. Can you say flatly you see no need for replacement cost accounting?

A. Yes. But let me add one other factor, and I want to repeat what I said before for emphasis. That is, if the corporations really and truly believe that there ought to be additional depreciation shown because of the fact that they're incurring this economic cost, then I say, just put into your income statement the numbers of dollars of depreciation that you're putting into your tax return. At least this would be a demonstration of good faith.

* * *

Q. How about municipal finance, Abe? After all, this is now 1976, and certainly the

greatest scandals in the past 12 months have involved New York City and New York State. Do you plan to turn your attention to this area?

A. Frankly, it is something that I would turn to rather reluctantly because my background would not fully and adequately prepare me for moving into that particular realm. But it's probable that I will be drawn into it increasingly. A couple of years ago, you may recall, I was a member of an ad hoc committee of the Controller of the City of New York, Harrison Goldin, looking toward the possible introduction of independent CPAs to audit the accounts of the City. I subsequently resigned from it. As it was reported at the time, I resigned not because I was opposed to the independent audit, but rather because I doubted the ability of our accounting firms to be able to mount such a project. Also I thought the approach ought to be to elevate the status of those who are engaged in the control function within the City, rather than to keep on denigrating them whenever something important had to be done by bringing in an outside group.

But what really triggered my resignation was the Controller's determination to go public with three mini-reports on three tiny funds. This, remember, was in June and July of 1974, pointing up only flyspecks. I felt that this was inappropriate in terms of the total responsibility that this ad hoc committee had assumed. The Controller responded that he was making a political decision, and his decision was to release those reports. I'm really an apolitical person.

Q. Nonetheless, you think you may pay a revisit to the realm of municipal finance?

A. It's quite possible. Oddly enough, just the other day I accepted an invitation to address a group of interns working in Albany on state budgetary matters on how one reads financial statements within the government sector. Having accepted this engagement, I'll at least have to make a start into the subject. But the point I would like to make on that score, and I believe this is the transcendent point, is that the municipal, state and federal finances are suffering from the same lack of accountability and integrity that we collectively have inveighed against in the private sector.

Q. That's a powerful statement.

A. It is and I intend it to be such. When you think in terms of the off-balance-sheet financing that's being carried on right now by the federal and state governments you find the same lack of integrity, the same use of gimmickry, the same getting around the field rules of public responsibility and accountability. I believe that, in time, the biggest single pool of unaccounted-for liabilities would have to do with our Social Security program and possibly also the federal pension programs. If we were writing about it in the corporate sector, we would say here is an enormous blob of liability that is not being recognized currently. I don't know how many trillions of dollars may be involved.

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Excerpts from Barron's interview, 19 April 1976

Corporate Pay-Offs

Accountants, Says Honest Abe, Should Blow the Whistle

ABE, a great deal has been said and written lately about corporate bribes and payoffs. Have accountants been shirking their responsibilities in this area?

A. Very much so. In one important respect, my continuing anxiety about accounting has to do with the failure on the part of my colleagues to set forth an articulated program with respect to the bribes, kickbacks, payoffs and other manifestations of deception — if not outright fraud — perpetrated at the highest levels of their clients' executive hierarchy.

However, while I would want to continue to study the past to determine how and where these things occurred, I am more interested in how we move towards the future. I could almost forget about the past if my colleagues would indicate how, from here on out, we're going to proceed. I would like them to say that if any executives have hookwinked us, that they're going to blow the whistle.

Q. With a qualified opinion?

A. I would go even further, because in most instances, qualification may not be required because of the usual standard of materiality. I would have the auditors perform as corporate surrogates, or ombudsmen. They should be in a position to say, either that the executive goes, and the reasons for his going will be made clear and overt, or we go, and we're going to make clear the reasons why we are resigning.

Q. Why should accountants undertake such a role?

A. Because someone has to. If the accountants don't—and they are the principal ones in the private sector responsible for it—it means that we may have to introduce a super-governmental bureaucracy to carry it out. And I would prefer to solve this prophylactically rather than pathologically.

* * *

Q. What you're really saying is that the loyalty of the accountant is first to the shareholder rather than to management.

A. I go even beyond that. I say, and I'm not here engaging in platitudes, an accountant's responsibility is to the total society. His responsibility to management is no greater than to other sectors of the total society.

Q. Well, it would seem his responsibility is first to his own integrity.

A. Precisely. But, we must remember that an accountant's third-party responsibility is unlike that of a lawyer's in an advocacy situation, where the lawyer represents his client in a criminal case or civil action.

Q. But an accountant is paid by management?

A. The answer to that, and, again, I don't mean to be quixotic here, is that the accountant has to be blind as to who's signing that check. But it's not the corporate president's money. He is merely an intermediary or fiduciary in behalf of the corporate entity.

Q. What is the accountant's function here? Is he to make an economic or a moral judgment?

A. I'm willing to start by applying

Occam's razor by saying, let it be economic. Now what does that mean? Let's take the $600 million on Lockheed's books with respect to its TriStar program. If the auditor determines, as I personally believe he should, that the discontinuance of bribes will put into serious jeopardy the viability of the TriStar program, I say this in and of itself—as an economic issue—should signal a writeoff.

Q. But suppose Lockheed's auditors know that Lockheed is successfully implementing this program through bribes?

A. They should indicate as an incident to their disclosure of the company's practices and policies of operation that this is the modus operandi, possibly the modus vivendi, of the corporation with respect to this program.

Q. Are you saying it should be at the top of the financial footnotes?

A. Yes.

Q. And that would be sufficient as far as discharging the accountant's responsibility?

A. If he describes the pattern of activities. Or, if he finds that the system being implemented for the payoffs—as with Gulf Oil, as the McCloy report made clear—circumvented the internal control procedure of the corporation. We're not asking the accountants to be the judge of morals here. But if in a particular industry, a certain pattern of activity is deemed to be inexorable for one reason or another, just let them spell it out. Then, at least, the market will be able to judge the extent to which a company or its program is contingent on that sort of policy.

Q. But there is, beyond it all, a moral issue, is there not?

A. I believe so, yes. I suppose what keeps getting at me, as I read the McCloy report on Gulf Oil, is how persons of such dignity and such responsibility, generation after generation in terms of the corporate hierarchy, could behave this way.

Then, I ponder the same question raised by the trustee in bankruptcy when he concluded that long report on Equity Funding. He said the question ultimately that he could not wrestle with is, how could so many persons be involved in this devious intrigue and not one—not one—manifest a pang of conscience and blow the whistle? Even at the end, Secrist did so by speaking to Dirks. But, as the trustee said, not because of any pangs of conscience, but because of the fact that he was fired.

Q. You can extend that, Abe, to those who took the bribes in this country. None of these people has ever been brought to account.

A. True.

* * *

Q. Abe, you touched on Lockheed a little while ago. You've been critical of their deferral of TriStar costs, and now the company has indicated that it will be writing off these expenses over a 10-year period. Does this square the account?

A. Not by any means. My contention has long been that Lockheed's auditors and managers knew, or rightfully should have known, that such a deferral was entirely unwarranted in the first place. I can quote reports of the Comptroller General of the United States and other sources to demonstrate that Lockheed, by ignoring evidence that its sales target was unattainable, was perpetuating a canard. Now, they are going to take that over half billion dollars in L-1011 deferrals and dispose of them on the instalment basis—$50 million a year, or $12.5 million a quarter.

Q. Well, at least they've decided to bite the bullet.

A. For me Lockheed's action in perpetuating such a hoax for a decade can only be described as an attempt to

abort the abomination through attenuation. Lockheed hasn't yet bitten the bullet, and for good reason. The only fair and proper treatment—in short, a writeoff—would have a devastating impact on its balance sheet. Even with the inclusion of more than $500 million in deferrals the company has only about $75 million in total shareholders' equity.

It is likely that Lockheed will soon try to implement the debt restructuring engineered last year by Felix Rohatyn, whereby $200 million in debt would become an equivalent amount of preferred stock. If so, this would be yet another Lockheed hoax. The stock, with sinking fund and mandatory redemption provisions, would be nothing more than a debenture bond. The only essential difference between the two kinds of securities is that the banks and other corporate holders of the "preferred stock" would get their yearly income 85% tax-free. Only a company like Lockheed would think of mounting such an expedition. What you have to wonder about, is how an accounting firm like Arthur Young, whose senior partner sits at the head of the Financial Accounting Foundation, can go along with it.

* * *

Q. Let's turn to taxes. There have been a number of proposals to achieve greater equality and close the loopholes, including eliminating deduction and substituting a flat tax rate. Do you think it can work?

A. The tax law, you've got to remember, is intended primarily as a revenue producer. Additionally, it seeks to fulfill a number of other objectives—mostly economic, some social, but all political. This particular proposal has considerable potential for inequity, just as the laws we already have on the books. It's a panacea, and my view is that under prevailing circumstances it simply is not feasible.

Q. What's the alternative?

A. In the present environment, about all that we can hope for is that Congress will move aggressively to eliminate the recognized loopholes—real estate, oil, films and so forth.

Q. How do you get Congress to act?

A. Through the public, which must be made to understand that a tax shelter—whether it be in equipment leasing, oil development, real estate or motion pictures—is nothing more than a subsidy. In other words, it is the equivalent of a payment by the Treasury to a particular group of taxpayers. In some cases, the tax loopholes were created by administrative fiat—for example, the excessive depreciation benefits permitted to syndicates or the ways in which oil companies are permitted to figure foreign tax credits as an offset against U.S. taxes. Congress never wrote those into law.

Q. Our tax system has been criticized for years and suggestions for reform have been made just as long, yet nothing ever gets done. What makes you think it can happen now?

A. I don't know if it can. But then, so has sin been around for millennia.

Q. Any thoughts, Abe, on the use of tax reform to achieve social goals?

A. Taking the long-range view, I would favor—and this is something I have been urging for some time now—a negative income tax. This would involve extending the income tax schedule down to those with zero income, at which level they would receive payments from the government. In this way, we can eliminate many of the costly welfare and other social benefit programs we now have.

* * *

Excerpts from Barron's interview, 26 April 1976

Accountable Accountants

To Abe Briloff, That's the Professional Ideal

HOW do you rate the Financial Accounting Standards Board?

A. I must admit that I never expected too much from it. As a consequence, it has not disappointed me.

Q. Something basically wrong with the idea?

A. I could accept the concept. After all, there was going to be this independent body of seven persons, who would be detached from their regular pursuits and activities. They would be committed to discerning what is fair and, after listening to various alternatives, promulgate new standards. But then several things happened. The first was that some of the people designated left much to be desired.

Q. Who picked them?

A. A group called the Trustees Financial Accounting Foundation. The trustees, in turn, are chosen by the American Institute of CPAs. And one of the fatal flaws, as it has evolved, with respect to the Financial Accounting Standards Board is that its financing has come primarily from the Big Eight accounting firms.

Q. How would you have had it financed?

A. I suppose it's easy for me to talk in rather glib, general terms. But I might have preferred that all publicly-listed corporations be assessed a certain sum, perhaps predicated on the aggregate market value of their shares. It's just one possibility. But the purpose would be to do away with that umbilical cord to the major accounting firms.

Q. Would you have chosen the members of the FASB differently?

A. I have no objection to the Financial Accounting Standards Trustees nominating members. But I would have wanted those persons nominated to be subjected to the same kind of rigorous probing as one might apply to a candidate for the judiciary.

Q. A confirmation hearing in a public forum?

A. Yes.

Q. Abe, which accountant besides yourself could possibly withstand such a probe?

A. There are a great many who could, and I don't know whether I could withstand such a probe. But yet I would say that if I aspire to that position, I should be subjected to it. Let me illustrate the reasons why I say this. Take the

current chairman, Marshall Armstrong, who's undoubtedly a very nice gentleman. But let us remember that he was the president of the American Institute of CPAs in the critical period, 1970-1971, when pooling-of-interests accounting was one of the most controversial items facing the profession. I read his speeches while he was president—they pretty much ignored the issue.

Q. Can you be specific?

A. For example, their decision on research and development expense, which required that henceforth such costs should be written off. What they also said was that companies must restate retroactively amounts previously capitalized. And as a consequence, the corporations never had to flow those costs through their reported income.

Q. It made the comparisons look that much better.

A. Right. The companies never bore the cost of the writeoff.

Q. But forgetting about the one-shot or the retroactive effect, how about the principle involved?

A. There is no principle involved. To be sure, it's a standard that I would be able to justify on the ground that it avoids some of the metaphysical, hypothetical determinations that otherwise might be required. However, to a degree it is compromising the accrual concept of accounting, whereby we do try to match costs and revenues with an important degree of logical relationship.

Q. But, Abe, something is going to have to be compromised.

A. Agreed—except that I believe an auditor committed to ferreting out a meaningful response with respect to the income implications of the research and development costs could reach a more logical response.

Q. But isn't that one of the problems of accounting? How can an auditor know whether something on which R&D was being deferred will ever work?

A. Let's go back for a minute to the enormous buildup of R&D by Lockheed with respect to its TriStar program, where Arthur Young was permitting the deferral of over $500 million. Here, the auditors knew that this was a highly contingent asset, only remotely capable of being realized. But yet they went ahead and permitted it. Now, I don't know what should be done on a general basis, but I must presume that corporate managements do have a visible record as to their sales potential from the R&D expenditures. Thus, you determine a payoff period and set up a table with a cutoff, so that by the end of the first or the second year, if the attained goals are not met, the accountant can make the appropriate adjustment. Incidentally, this is the practice followed in the

Or, to be even more specific, there's also Walter Scheutze. He formerly was a partner of Peat Marwick and, by the way, recently submitted his resignation from the FASB and plans to return to that firm. When Mr. Scheutze was designated to the FASB, he was described as the one at the firm responsible for auditing and ethical standards and practice procedures. In view of those responsibilities, I would have wanted to know where he was in Penn Central, in National Student Marketing, in Stirling Homex or in Bar Chris. If it turned out that Mr. Scheutze saw what was going on and condoned it, then the FASB would not be where he belongs. Now they may be just the gentlemen we are looking for to sit on the FASB, but we should let some light in before we entrust them with such decision-making powers.

* * *

Q. How about the standards as such? What do you think of them?

A. They're not essentially different from what the Accounting Principles Board might have come up with. And they are heavily compromised. They have, to a certain degree, been even more perverse than the Accounting Principles Board would have permitted them to be.

Q. Can you be specific?

A. For example, their decision on research and development expense, which required that henceforth such costs should be written off. What they also said was that companies must restate retroactively amounts previously capitalized. And as a consequence, the corporations never had to flow those costs through their reported income.

Q. It made the comparisons look that much better.

A. Right. The companies never bore the cost of the writeoff.

Q. But forgetting about the one-shot or the retroactive effect, how about the principle involved?

A. There is no principle involved. To be sure, it's a standard that I would be able to justify on the ground that it avoids some of the metaphysical, hypothetical determinations that otherwise might be required. However, to a degree it is compromising the accrual concept of accounting, whereby we do try to match costs and revenues with an important degree of logical relationship.

Q. But, Abe, something is going to have to be compromised.

A. Agreed—except that I believe an auditor committed to ferreting out a meaningful response with respect to the income implications of the research and development costs could reach a more logical response.

Q. But isn't that one of the problems of accounting? How can an auditor know whether something on which R&D was being deferred will ever work?

A. Let's go back for a minute to the enormous buildup of R&D by Lockheed with respect to its TriStar program, where Arthur Young was permitting the deferral of over $500 million. Here, the auditors knew that this was a highly contingent asset, only remotely capable of being realized. But yet they went ahead and permitted it. Now, I don't know what should be done on a general basis, but I must presume that corporate managements do have a visible record as to their sales potential from the R&D expenditures. Thus, you determine a payoff period and set up a table with a cutoff, so that by the end of the first or the second year, if the attained goals are not met, the accountant can make the appropriate adjustment. Incidentally, this is the practice followed in the amortization of motion picture film negative cost.

* * *

Q. Really, this seems to lead us to a basic but critical question: is there such a thing as generally acceptable accounting principles?

A. No. There is a nexus of rules and precepts, all of which are subsumed in something that we call Generally Accepted Accounting Principles. I'm willing to take the framework of generally accepted accounting principles with its alternatives. But I would then want the accountant to use those rules or applicable principles that he believes best reflect the situation as he sees it. In other words, at the present time, within the framework of GAAP, there are alternatives, which, if properly applied, could fairly portray truth.

Q. Then you're in favor of alternatives?

A. Precisely.

Q. But in any given situation, might not accountants differ as to which principle is applicable?

A. Yes. And I know the implication might be that this then might produce some kind of a shopping around for accountants, and you could have a race for the bottom. Then I must come back to the point that one must rely on the integrity of the accountant. If you put the burden on the professional conscience of the accountant, you would get a far fairer response to the undertaking than that which prevails at present, where it's management who says what comes out at the tail end.

Q. To achieve that kind of goal, wouldn't you necessarily have to limit accountants to auditing?

A. I would like to develop a professional identity for the third party responsibility by isolating professional firms that are committed to the audit function and to make of them auditors qua auditors. Essentially what I'm trying to say—and forgive this flight of fancy—is that the auditors that I envisage should be elevated from the day-to-day interrelationships in working with clients, just as I expect the judiciary to be elevated from any day-to-day involvements in the practice of law.

Q. Do you think that some of the other activities accountants have branched out into compromise them?

A. Oh, yes, because if they provide management consultant services, they're engaged, for example, in the determination of which companies might be appropriate targets for acquisition. I can conceive of situations where after a target firm has been identified, the potential acquirer actually interposes its traditional auditor into the situation to get the potential takeover target ready for the ultimate nuptials.

Q. To turn this full cycle, then, you're suggesting it doesn't really matter whether we have an APB or an FASB, if you have a different kind of setup within the profession?

A. The challenge is not with respect to our accounting alternatives, because, when you reflect on that which we have, you will find no lack of good alternatives. In fact, if you go back over the various articles I've written—whether on land developers, conglomerates, Telex or whatever—there were good alternatives that could have been applied. But because the managerial objective was otherwise, principles were interposed to produce, at least in my estimation, what was a distorted presentation.

* * *

Q. What objective should the profession be striving for?

A. To re-emphasize and give meaning to the word fairness, which at present appears only equivocally in our auditor's certificate. Remember, an auditor's certificate says that the financial statement is presented fairly in accordance with GAAP. But then there's the hidden hedge which is not in the financial reports per se, but which remains one of our very first auditing precepts. It says that the financial statements are those of management and not of the accountants. So that while we say, "presents fairly in accordance with GAAP," and the public is presumed to infer that we've been the knights on horseback who have fought the good fight in their behalf and have ferreted out the ultimate truths, it's not always so. These are not the auditor's statements but management's. I want to reverse that.

Q. You want to change the code?

A. I want to shift the burden to the auditor. I want the auditor who is reviewing the economic events with respect to that enterprise, based upon his professional integrity and professional consciousness to develop the financial statements which he believes will present the economic events fairly. As an incident to that, I'm willing to say he can select from the alternatives in GAAP those he considers most appropriate.

Q. Okay, what is fairly?

A. At the moment, I'm willing to fall back on a negative response: the avoidance of the unfair. That which we can discern to be unfair.

Q. Unfair to whom?

A. Unfair to those who are relying on the statement and who will be inferring things from the statements which we know they will be inferring, but nevertheless are inappropriate. If you'll forgive the reference to Polonius' advice to Laertes, I would probably want to say to the auditors—be fair to yourself first, and then it follows like the night the day.

* * *

Q. Abe, do you see a shift in the SEC's so-called activist role in accounting? Is there more of a benign approach?

A. From what I've observed, the answer is yes. I don't see the SEC involved in controversy to the extent that it was in 1973-1974—first under Casey and then under Garrett. The only direct activism that I can see at this particular time probably has more to do with supporting this enforcement attack as we move toward the disclosure of foreign payoffs, bribes and the like. And I suppose that to answer your question from another vantage point, the fact that Sandy Burton, the SEC's chief accountant, is no longer being criticized by my colleagues in the profession would indicate that the SEC is taking a more benign view.

* * *

Q. This brings into focus another area we've yet to touch upon. Does the profession have any self-policing powers?

A. There is within the American Institute of CPAs an ethics division, with a very elaborate apparatus. However, I must condemn the disciplinary process. We have various committees and subcommittees, trial boards and the like. But it ends up, as St. Matthew put it, by straining at gnats while swallowing the camels.

Q. Will you elaborate?

A. Oh, they will censure an auditor who happened to have transcended the rules regarding advertising. But those involved in more serious matters, and that can go alphabetically from Ampex to Yale Express, somehow have escaped the disciplinary process. Mind you, this is not a problem unique to accounting. We hear of it in the medical profession and among lawyers. But all I can say is that I am within the accounting profession and therefore I see it there far more directly.

Q. What would you have the ethics committee do?

A. Well, the profession itself can do nothing more than suspend or expel a member from membership. But that stigma, particularly when underscored by a public announcement of the action, can have a salutary effect. Moreover, once there has been a determination within the profession, the state regulatory bodies—by that I mean licensing agencies such as New York's State Education Department — would then have the record for review to deter-

mine whether the violation, in itself, has produced a deviation from the rules of professional conduct.

Q. Are actions always against individuals?

A. The actions reported within the AICPA have been against the particular persons who have been involved. The SEC's disciplinary actions have generally been against firms. I would prefer to combine it in some way. We should identify the particular individual who may have fouled the nest. But, then, if a particular firm showed an inordinate proclivity for erring we should then look to the state regulatory agency to determine what might well be done with the licensing of the firm per se.

Q. Abe, why do you think there has been inadequate disciplinary action?

A. Well, I believe that the apparatus at the Institute is controlled excessively by the major accounting firms. And it's they who have produced the causes celebres which have, in turn, produced this crisis in confidence with respect to the profession.

* * *

Q. Just to wrap things up, what do you think will be the big accounting controversies of '76?

A. I really don't know. I would say that it might be the total environment of accounting. I have been reflecting—maybe brooding is a better word—about the environment of accounting in its totality, rather than trying to think in terms of any particular isolated problem. The critical issue may well turn out to be this whole process of the auditor's responsibility for assuring corporate accountability and visibility.

Also, although I don't know when it will come forth, and I don't even know how substantive it will be, the Cohen Commission—the one chaired by former SEC Chairman Manuel Cohen, called the Commission on Auditor's Responsibility—may have some kind of impact, in terms of developing a response from the profession and from the financial community. But if I were to hazard a prediction from where I sit at this particular moment, I see nothing exciting coming forth.

Q. Why do you say that?

A. The commission is heralded as an independent commission and is chaired, obviously, by a non-CPA who certainly has a great deal of sophistication in this whole area of the securities markets and financial operations. However, the critical staffing has been left to the American Institute of CPAs. And, as I put it to my students only the other day, this is very much like sending the goat to guard the cabbage patch.

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School of Business and Public Administration

March 24th, 1976

Honorable Charles A. Vanik, Chairman
Committee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

My dear Congressman Vanik:

I refer to your letter of March 9th inviting my comment on the new system of depreciation recently adopted by the Department of Commerce in its development of GNP data. In that connection I have reviewed the Department's Bureau of Economic Analysis release dated January 16th (reference 76-3) as well as the article in the January issue of the Survey of Current Business which discusses the revision in the data regarding the "capital consumption adjustment".

Your letter expresses an appropriate concern lest "this new system might eventually be used by corporations in calculating their tax on corporate net income".

That this concern is well founded can be demonstrated by the assertion in the Securities and Exchange Commission's '33 Act Release No. 5608/August 21, 1975, proposing "disclosure of certain replacement cost data in notes to financial statements". To rationalize its proposal the release noted that: " . . . {T}he Commission has noted the development of proposals to permit business entities to calculate depreciation for tax purpose on the basis of current replacement cost . . . . . {citing an Australian study as support}".

Last November, when addressing the New York State Society of Certified Public Accountants SEC Commissioner Philip A. Loomis extended the carrot for the CPAs there assembled, telling them to go along with the Commission's proposal if their clients wanted to get the benefit of the added, hypothetical write-offs for tax purposes.

That the pincer movement is in full force can be demonstrated by the aggressive stance taken by our major accounting firms, especially Arthur Andersen & Co. For example, last February Mr. Harvey Kapnick, the chairman of that firm, delivered an Emanuel Saxe Distinguished Lecture at my college urging the adoption of fair-value accounting ---

a process which would produce a negative impact on income essentially corresponding with the impact of price-level or replacement-value adjustments. (I enclose a copy of his address).

That the Kapnick approach would produce grotesque consequences in practice was confirmed, in my view, during the open colloquy which followed his address. Thus, I alluded to Arthur Andersen & Co.'s dismal failure to discern fair value in such aggravated cases as Mattel, Inc. (involving an inventory hoax); Investors Overseas Services (whereby Cornfield arbitrarily jacked up a $17 million investment in arctic lands to $119 million, permitting him to skim $10 million for his efforts); and Four Seasons (whereby percentage-of-completion accounting was used to inject specious balance-sheet values and income into the statements).

Mr. Kapnick's responses (as I believe the unedited tape recording would confirm) were essentially unresponsive, and to the extent they might be deemed to have been responsive his answers would confirm my assertion that any movement from the verifiable objective basis of historical cost would be the opening of a Pandora's Box. And woe unto the non-corporate taxpayers who would be constrained to absorb the taxes shifted from the already seriously eroded corporate tax structure.

I am unequivocally opposed to this tinkering with the depreciation charge; I had expressed my carefully considered views in articles published in <u>The Accounting Review</u> in 1958 and 1961*.

More recently I have restated my continuing objection to this potential hoax in my <u>More Debits Than Credits</u>, (Harper & Row, 1976). A copy of the relevant pages 297-306 is associated with this letter.

And there seems to be no end to the greed of the corporate sector in our midst (and of the accounting and legal advisors and others who are aiding and abetting the corporate lobbying proclivities). For example, the 1975 United States Steel report just came to my attention last week. Footnote 10 states baldly that the 1975 effective rates of tax was 32.1 percent, compared with 39.0 percent the year before. But even more significant (if not sinister) is the fact that the "currently payable" tax for 1975 was about 20 percent of the pre-tax income, in sharp contrast with the over 33 percent for 1974. (Be it remembered

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*"Price Level Changes and Financed Statements: A Critical Reappraisal," July, 1958, pp. 380-388; and "Price Level Changes and Financial Statements at the Threshold of the New Frontier", October, 1961, pp. 603-607.

that our governments cannot meet their current needs from the "timing differences" portion of the corporate taxes).

United States Steel is not doing anything illegal; in fact, as you have made abundantly clear in addressing the Congress, there are giant corporate enterprises in our midst reporting profits beyond dreams of avarice but feel no compunction in paying relatively infinitesimal sums to our Government. No, U.S. Steel, et. al., are not doing anything illegal -- it's all just immoral. And now these corporate enterprises (aided and abetted as noted above) are desirous of denying to the governments which provide them with protection and other vital services the mere soupcon of taxes which they may be compelled to pay presently.

The point was made in my More Debits Than Credits; it stands out vividly in the 1975 U.S. Steel report. If the corporation wanted to show an added cost for depreciation to reflect more appropriately the current economic cost, all it need do is to factor into its statements the same depreciation amount it uses on its income tax return form 1120. Instead one can infer from U.S. Steel's footnote 10 that its tax deductible depreciation exceeds its financial statement depreciation by a staggering $230 million or more. Thus, the timing difference for depreciation alone produced a tax deferral of $96.2 million last year. Using a 40 percent tax rate this means that the depreciation differential, per se, was in excess of $230 million. If we were to apply the company's 32 percent overall rate for this extrapolation the depreciation divergence would come to a mind-boggling sum of a third of a billion dollars.

Clearly the problem alluded to in your letter of March 9th transcends debits and credits; it goes to the heart of our tax structure and thereby to the ordering of priorities in our total society.

As you are undoubtedly aware Senator Lee Metcalf has expressed his strong concern regarding the juggling of the data when writing to the Securities and Exchange Commission in opposition to its August proposals.

You may use all or part of the foregoing and the attachments for the public record. And should circumstances dictate public hearings on this issue please feel free to call on me.

With highest personal regards,

Cordially,

Abraham J. Briloff
Professor Accountancy

AJB/hi

PUPU ACCOUNTING

It is a self-evident truth that all economic units—families, individuals, governments—are vitally affected by double-digit inflation. This phenomenon could be seen to cut both ways; for those who are net debtors, the ability to repay in cheaper dollars is a plus, whereas the creditors who have claims to naught but a fixed dollar amount are adversely affected.

Reciprocally, those who own long-term assets (buildings, manufacturing facilities, copyrights and patents entitling the owners to a royalty predicated on prevailing sales prices, are all favorably situated; whereas those who are constrained to purchase goods and services out of relatively fixed amounts of income (bond interest, annuities, pensions) are adversely affected.

Corporations confront the inflationary dynamics from a number of vantage points. On the one hand they own substantial facilities acquired over the years at presumed lower price levels and are using these facilities currently, generating amounts of revenues in excess of those which may have been contemplated when the fixed capital investment was undertaken—but where these increasing dollar inflows may not exceed the *real values* of such anticipated revenues. To demonstrate that there may be a mismatching of costs and revenues, let us assume that in 1958 a widget manufacturer purchased a widget extruder (when price levels were indexed as 100) for $25,000; the manufacturer's "capital budget projections" presumed that widgets would be extruded over a twenty-five-year period and that each year's product would be sold for $2,000. Using an unsophisticated calculus, the manufacturer anticipated annual income of $1,000 (i.e., the $2,000 revenue less the $1,000 in depreciation, ignoring all other costs for this purpose).

Now then, comes the year 1974; because price levels are at 170 (in relation to the 1958 base), the manufacturer sold the extruded widgets for $3,400 rather than $2,000. (In other words, he was able to adjust his selling prices to compensate for the erosion in the dollar.) In that event the traditional accounting configuration would show:

Revenues	$3,400
Depreciation	1,000
Income	$2,400

Everyone should recognize that there is an incongruity here since the $3,400 is being stated in 1974 dollars while the $1,000 is in reality a vestige of 1958 dollars. And now the metaphysicians get into the act, developing all sorts of circles, arcs, and chords in order to transmute the numbers and make them harmonious.

One approach could be to say the $3,400 is nothing more than $2,000 in 1958 dollars (i.e., $3,400 ÷ 1.70)—and then to say

the ostensible $2,400 profit is nought but the $1,000 budgeted amount.

Another approach would be to reverse the stream of conjecture and to say that the $1,000 in depreciation should really be shown as $1,700 ($1,000 × 1.70), making the realized gain $1,700. And if the manufacturer then looks at the $1,700 gain and says to himself that it's no more in real purchasing power terms than the 1958 targeted $1,000 income, well, no one could stop him from talking to himself.

Clearly, dear reader, you can take your choice in this rarefied numbers game: You can call the profit $2,400, $1,000, or $1,700 depending on how you look at this Rorschach test. The reason for all this confusion is that our accounting process presumes that a dollar is a dollar is a dollar while anyone exposed to reality knows this to be nonsensical. But then so is the whole historical cost approach to accounting nonsensical, and should be abandoned—unless, as it turns out, every other alternative suggested thus far is even more so.

In any event, so urgent was this matter deemed to be in mid-1974 that the then newly formed Arthur Andersen Public Review Board turned its attentions away from the serious ethical and practice problems then confronting the firm to use the Board members' highly significant political and professional credentials to write an open letter addressed to the President of the United States. As published in the firm's "Executive News Briefs," the Board's letter was described as "urging [the] need for prompt action to achieve improved reporting of economic reality by business enterprises in the current inflationary period." After paying lip service to the Board's concern that "changes in the dollar wages received by the working man today do not reflect changes in his true wages," the letter proceeds to give President Ford a lesson in basic accounting (not unlike the comments which introduced this segment), and then gets down to the business at hand:

> Although the direction and magnitude of the resulting departures from economic facts vary greatly from company to company, histori-

cal cost financial statements generally overstate real earnings during periods of inflation. Such overstatement occurs because companies match the old historical dollar costs of plant and equipment and, frequently, goods in inventory against sales stated in current dollars, thereby giving rise to fictitious profits. Based on current trends, the overstatement of pretax earnings of American business attributable to "inventory profits" and understated depreciation amounts to many billions of dollars annually. Reporting such profits without an adjustment for inflation not only undermines the usefulness of financial statements as a basis for reaching informed decisions, but also erodes vitally needed capital. This in turn slows business modernization and expansion, with a consequent loss of productive capacity and jobs. For these reasons, we strongly believe that you and your advisers should recognize these deficiencies in past and present financial reporting as you seek answers to the problems of inflation. . . .

And the letter concludes on this strident note:

With respect to future financial reporting of business enterprises, we are communicating, by copies of this letter, our deep and urgent concern to the Financial Accounting Standards Board and the Securities and Exchange Commission, the two responsible bodies with authority over the establishment of accounting and reporting standards, with our recommendation to adopt without delay standards which require that changes in price levels be reflected as supplemental data in future published financial statements. There is no need for delay since the procedures to prepare price-level adjusted financial data have already been developed. Failure to make these changes, we are convinced, would aggravate inflation, frustrate efforts to deal with it, and contribute substantially to the risk of far more serious economic dislocation in the future.

And the Financial Accounting Standards Board responded. Early 1975 brought forth its Exposure Draft of a proposed statement on "Financial Reporting in Units of General Purchasing Power." It is this mode of accounting which the SEC's Chief Accountant has dubbed PuPU (for Purchasing Power Units) Accounting—an appelation for which I tip my hat to Sandy Burton.

That draft calls for business enterprise to develop a set of supplemental statements derived by applying the Gross National

Product ("GNP") Implicit Price Deflator to the traditional financial statements. Included in that release is a detailed template for effecting the conversion to PuPU, telling about how monetary assets and liabilities are to be treated in contrast with the nonmonetary assets and liabilities. It is the latter which is subjected to the more dramatic plastic surgery by applying the formula:

> Cost of nonmonetary asset or unit-of-money amount of nonmonetary liability *multiplied by* Index at end of current period *divided by* Index at date nonmonetary asset was acquired or nonmonetary liability was incurred.

The monetary/nonmonetary dichotomy emphasized in this operation is entirely consistent with the current-historical duality which was central to the Board's proposed statement on foreign currency conversion, making inescapable a reference to the Emersonian wisdom about a foolish consistency. . . .

In essence the FASB approach would apply the GNP deflator to each item on the income statement and balance sheet so as to convert the various items to a hypothetical number ostensibly representing the number of dollars which might have been invested currently (or received currently) in the particular transaction to which the deflator is being applied.

Let me see if this process can be made sensible. Assume that in 1958 the Underwater Land Sales Corporation acquired 1,000 acres of Florida land at \$100 an acre to be sold to lemmings looking for recreational land sites. The land has not yet been sold and is being carried in Underwater's balance sheet as undeveloped land, \$100,000. Since the 1974 GNP price index is 170, the PuPU number is determined by multiplying the \$100,000 by 1.70, giving the restated number as \$170,000.

Similarly, the Subterranean Resource Corporation, also in 1958, acquired 1,000 acres of land, also at \$100 an acre, for resource exploitation—and the area has since proven to be loaded with gas. This land is also carried in this company's balance sheet at \$100,000 and would also be restated as \$170,000 PuPUs.

The FASB members are not oblivious of the absurdity which the

Exposure Draft would perpetrate since, at paragraph 8, they made clear that such a general purchasing power restatement does not measure "current value," thus:

> It would only be coincidence if the cost of an asset restated from units of money to units of current general purchasing power resulted in a measurement that is equivalent to that particular asset's "current value." . . .
>
> For example, if the $10,000 cost of the land cited in paragraph 6 [of the Exposure Draft] were restated to 14,605 units of the general purchasing power of the dollar in 1973, it cannot be inferred that the land could be sold or replaced for $14,605 in 1973. All that can be inferred is that the equivalent of the general purchasing power of $14,605 in 1973 was invested in the land when it was acquired in 1964.

There you have it. The fact that the lemmings will not swarm to Underwater Land Sales nor that the Subterranean Resources' land is potentially a money gusher is of no significance in this Rube Goldberg labyrinth. Both companies will put $170,000 (1974 PuPUs) into their respective balance sheets for the 1,000 acres of land bought for $100,000 in 1958.

Why did the Board expose this nonsense as its gift to the 1975 New Year? According to the preface to the draft:

> The Board is taking action now on general purchasing power accounting because techniques for restating financial information in terms of units of general purchasing power are well developed, and the feasibility of applying them has been demonstrated in a number of field tests. Reporting current values would be a significant departure from the historical cost basis of accounting, and much work remains to be done in considering the concepts and implementation issues related to that proposal. Current value accounting is within the scope of another project presently on the Board's agenda, "Conceptual Framework for Accounting and Reporting."

And so because this "magic mountain" is there, FASB is determined to climb it—and to make the public pay for this expedition to Erewhon.

At the University of California in Spring, 1974, Dr. Burton addressed himself to this notion of PuPU accounting, saying:

While the ease in application cannot be denied, since no new economic measurements must be made, there are serious doubts as to whether any significant benefit will be achieved from such a system. In fact, strong arguments can be made that the data produced by a general price level adjustment system may be affirmatively misleading rather than helpful to the users of financial statements. These arguments must be considered with care before any system using such measurements is mandated on either a primary or supplemental basis.

In essence, financial statements adjusted for a general price level change represent a measurement system based on historical costs expressed in terms of a purchasing power unit. In the interests of easy communication, this may be called PuPU accounting. There is no reason to think that PuPU accounting will produce any better a measure of long-run average cash flows than will historical monetary units. In the first place, since the impact of inflation falls with dramatic unevenness on various sectors of the economy and various parts of firms, the relationship of historical PuPUs to current cash outflows is tenuous at best.

* * *

Not only will PuPU accounting suffer all the disabilities of any historical cost system, but it will have an additional significant potential for misleading investors arising out of the fact that it will appear to be an improvement when it is in fact not. This danger is particularly acute if the PuPU system is anointed by the Financial Accounting Standards Board as constituting significant and valuable new information.

While the benefits of PuPU accounting are difficult to perceive, the costs of adopting such a system on either a primary or supplemental basis are substantial. . . .

Return to the FASB Exposure Draft and take the illustrative case included as an appendix; what are some of the consequences of the conversion process? (Table, page 304.)

This income reduction is the consequence of manipulating many numbers, but for reasons indicated in my introductory discourse it

Re 1972 net income:	
On the historical (traditional) basis	$1,243
(about 11.5 percent of the shareholder's equity)	
On the restated basis	$ 658
(or 5 percent of equity)	
Re 1973 net income:	
On the historical basis	$ 883
(about 7.5 percent of equity)	
On the restated basis—a *loss* of	$ 378

is the change in the depreciation sums which critically contributed to the changes in the bottom line. Thus, for 1972 we saw the income reduction to be $585; the depreciation change alone amounted to $626. In the succeeding year when the net effect was a $1,261 reduction, the depreciation change amounted to $701.

Could it really have been the objective of all this Andersen-FASBian turbulence merely to permit corporations to deduct greater sums of depreciation on their financial statements, thereby reducing their reported income? Is this the way they saw the road toward the preservation of our American free-enterprise system—thereby demanding that the President of the United States be distracted from the many other weighty matters requiring his urgent attention?

PUPU: A TAX RIP-OFF?

In my view this could not possibly be the objective of this campaign. After all, as we saw in Chapter 6, U. S. Steel in 1968 found ways of drastically cutting its depreciation charge on the reports going forth to its shareholders, thereby substantially increasing the reported profits. Similarly, we saw in Chapter 7 that the typical American corporation now keeps two sets of books, especially with regard to the depreciation charge. Thus, the tax collector's set shows enormous sums for that item, thereby portraying the company as wearing sack cloth and ashes; the shareholders' set (the one certified by the independent attesting certified public

accountant, remember) shows a far more moderate charge, thereby displaying corporate opulence. If, then, the survival of the American free-enterprise system were to depend on the ability of the corporations to increase the charge for asset utilization when submitting their statements "to our shareholders," all they need do is to put the same depreciation amount into the books intended for the shareholders as is put into the tax collector's reckoning. But no, it isn't the shareholders who are supposed to be impressed with the concept that the depreciation sum may be unrealistic. Instead, as I see it, the President of the United States and the American public generally are being set up for a rip-off. Thus, I maintain, the whole purpose of this arithmetic mishmash is to obtain tax write-offs even greater in magnitude than the exorbitant sums presently allowable by the Internal Revenue Code, as exaggerated by the Regulations implemented in recent years under the Asset Depreciation Range (ADR) rubric.

And here, I further maintain, is where the FASBians, *et al.*, manifest their limited sense of professional outlook and responsibility; here is where they make known that for them, at least insofar as they define their professional concerns, there is but one sector in our economic universe, i.e., the corporate. They see themselves as the ministers or grooms to these entities—and the rest of the components of our total society could look to their own resources. In short, they are saying to the rest of the world in behalf of their corporate patrons, "We're all right, Jack."

Notice the myopic view of the impact of inflation evidenced by all these expressions of agonizing concern for the preservation of American economic enterprise. Except for the platitudinous expression of concern for the working man included in the Arthur Andersen open letter, where do they (or the FASB) make a plea that:

1. A pensioner should be permitted to index his current receipts so as to restate them in terms equivalent to the "real" dollars invested over the years (either by direct contributions to the cost of the annuity or by services over the years)?
2. A bondholder or savings account depositor presently collecting his interest and the principal amount of the bond or account should be

permitted to index his receipts or balances so as to restate these sums in terms equivalent to those initially invested by him?

3. A professional person and wage earners generally should be permitted to index their current revenues in terms equivalent to the price levels prevailing when they began their working careers?

The illustrations of the ravages of inflation could be greatly expanded. If, then, there is a demonstrated need for a rethinking of our systems of taxation and economic reporting to offset these perversities, then a profession, if committed to public responsibility, should direct its attention toward a complete reappraisal and not act as plea bargainers for but a single sector—especially where it could be demonstrated that this sector is, in fact, the beneficiary of inflationary trends. It is, I submit, this sector which is the one best equipped to lean into the wind. It is this sector which, through its long-term debt structure, is deriving huge benefits from its ability to repay this debt over time with cheaper dollars. And even more dramatically it is this very sector which is entirely capable of using its investment in plant and equipment, like our widget manufacturer, to utilize that investment in place to produce products and services to be sold to consumers at currently prevailing prices, hence, at prices far in excess of those contemplated when the investment was made.

Should this sector be permitted to play the role of the mendicant, and thereby induce an even greater flow of our society's resources into their apparently bottomless cups? Should the accounting profession permit itself to become the monkeys on the leash for these mendicants?

(Excerpt from Hearings before a Subcommittee of the Committee on Appropriations, House of Representatives)

DEPARTMENT OF DEFENSE APPROPRIATIONS FOR FISCAL YEAR 1975

WEDNESDAY, MAY 15, 1974.

NAVAL NUCLEAR PROPULSION PROGRAMS

WITNESSES

ADM. HYMAN G. RICKOVER, DIRECTOR, DIVISION OF NAVAL REACTORS, U.S. ATOMIC ENERGY COMMISSION

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UNIFORM ACCOUNTING STANDARDS

Mr. FLYNT. Let me follow that up with this in this same connection: There seems to be a continuous debate going on over adequate disclosure of contractors' corporate and financial data. Some critics claim that the reported figures are oftentimes misleading. Have you found this to be a problem in defense work and, if so, elaborate. The answer is yes, is that right?

Admiral RICKOVER. Yes. I would like to say a few words on it. For many years I testified that the lack of uniform accounting standards was a serious deficiency in defense procurement because it allowed contractors to account for costs in any manner they chose. As a result, it was not possible to determine the costs or profits on defense contracts without spending months reconstructing the contractor's books. With the creation of the Cost Accounting Standards Board and its requirements for standards and disclosures from companies regarding their actual cost accounting practices some progress is being made in this area.

There is, however, another field of accounting that has long been neglected and abused—the field of corporate financial accounting. What I am referring to when I talk about financial accounting are those accounting techniques used by companies to develop information presented in their annual reports to stockholders and the Securities and Exchange Commission. As you know, corporate annual reports play an important role in today's economy. The reports provide data for use by the public in making investment decisions. In general, high reported profits make it easier for a company to raise capital through the sale of equity—or new stock. High reported profits also help support the price of stock held by company officials. Reported profits and other published financial data are considered by creditors or potential creditors in assessing the risk involved in lending money to the corporation.

Besides its obvious value to investors and creditors, corporate financial data has come to play an important role in defense procurement. Corporate financial reports among other things are used by the Defense Department to assess a contractor's financial ability to perform defense work. Defense contractors cite figures from these reports in

efforts to obtain higher profits, claim settlements, or to change DOD procurement policy.

Given the importance of corporate annual reports to the economy as a whole and also to defense procurement, one would expect that the figures in these reports would accurately reflect the results of a company's operations and its financial condition. They don't. As was the case in cost accounting, companies have great latitude in how they account for costs and profit figures for financial accounting purposes. As a result, the figures are susceptible to manipulation and judgments which can dramatically change reported profits—all within the constraints of the so-called generally accepted accounting principles.

In dealing with major defense contractors day by day, I become aware of some of their financial methods. In comparing what I know with data from published annual reports, I am amazed at the disparity. I am also astounded by some of the "creative accounting" that enables a contractor to report a wide range of profit figures for a given situation. For example, under the so-called percentage of completion method of accounting for profits and losses on long-term contracts, contractors have the accounting flexibility to convert sizable losses into respectable profits or vice versa on an annual basis simply by changing management estimates of progress and contract revenues. Since work on a shipbuilding contract extends over several years, shipyards calculate profits based on the shipyard's own estimate of what will be paid to them under the contract at completion. These company judgments can contain a great deal of built-in flexibility; they are not subject to strict audit verification even by the company's independent auditors. When a contract is completed and the actual profit and loss is determined and appropriate adjustments made, shipbuilders can still mitigate the impact of the actual profits or losses by adjusting the profit estimates on uncompleted work.

Claims are another example. In some cases, contractors predicate their profit figures on the favorable outcome of claims under litigation with the Government. Yet, the reader of the financial report has no way of knowing whether management's estimate of the expected amount from claims is conservative or wildly optimistic.

There are also a variety of ways a contractor can vary his reported profits and they may differ from contract to contract. One defense contractor has four different methods of recording his current year contract profits and revenues. The particular method he uses depends on the actual profitability of the contract.

Although the reported figures certified by a public accounting firm convey the impression of precision and frequently are represented in that vein, the truth of the matter is that they are subject to the desires of management. Early this year, one contractor reported to the Government the financial results of his 1973 operations. A month later, he revised both his sales and profit figures downward by about $6 million. The company could have arrived at almost any other figure simply by changing estimates.

A management decision as to how certain costs are handled can have a big impact on a company's reported profits. A note in one company's annual report mentioned that the total cost estimates used to determine ultimate profitability on its Government contracts in-

cluded more than $100 million of non-recurring manufacturing costs associated with a new facility. The Government auditor found that this amount actually represents losses incurred by the contractor on previous contracts for nondefense customers. So here is a case where reported profits in a given year could vary by many millions of dollars upward or downward depending on whether management elects to write off the losses as they occur or to amortize them over future business as a nonrecurring manufacturing cost.

Depreciation expense is another area where figures can be adjusted. It is not uncommon for companies to use one method of depreciation in calculating profit for income tax purposes and another in developing its profit figures for stockholders. Similarly, contractors can report profits to the Internal Revenue Service based on a completed contract method but use the percentage of completion method for reporting profits to stockholders.

The present methods of financial accounting under generally accepted accounting principles can result in sudden hardships to investors and problems in defense procurement. In the past, companies have taken sudden, unexpected write-offs or even declared bankruptcy when the financial condition of the company finally deteriorated to the point that management could no longer remain solvent. Public accountants are supposed to be the safeguard against unreliable financial reporting. However, they are under intense pressure to go along with a company's accounting methods lest they lose the account to a competitor. The Certified Public Accountants, of course, certify only that all is in accordance with generally accepted accounting principles. I think that is just a euphemism for anything goes.

In the past few years, the accounting profession has come under increasing public pressure to get its house in order. Several accounting firms are the subject of stockholder lawsuits for alleged failure to require clients to publicly disclose their true financial condition. The public has finally begun to realize that the accounting profession's Accounting Principles Board was little more than a facade—a Potempkin village.

Goaded into action by public clamor and by the Government's demonstrated willingness, as in the creation of the Cost Accounting Standards Board, to step in and establish a standard-setting organization where the accounting profession was unwilling or unable to do the job, the accountants created their own Financial Accounting Standards Board. The Board was established in 1972 and is made up of seven full-time salaried members from the accounting, financial reporting, and academic fields. However, I have seen little results from the Financial Accounting Standards Board. It has developed only one standard in the year and a half it has been in existence.

The Securities and Exchange Commission also bears a responsibility for the present situation. The Commission, while having statutory authority to require proper accounting, has relied too much on public accountants to require fair reporting and to police the system. When companies with rosy financial statements certified by public accountants suddenly declare bankruptcy, the Commission should recognize the need to reevaluate the whole basis of its financial reporting system.

The Securities and Exchange Commission is beginning to show signs of concern. It has recently proposed an amendment to its rules for financial disclosure on defense and other long-term contracts. The proposal would require greater disclosure in connection with accounting for inventories and accounts receivable. This is a step in the right direction. The SEC proposal is now out for public comment. I predict stiff opposition by defense contractors and their industry associations because the proposal focuses attention on two areas which firms have used to manipulate reported profit figures. I hope that industry pressure does not result in the final regulation getting watered-down.

In summary, I believe the Congress is going to have to take an active interest in the field of financial reporting and to see that standards are developed which will adequately protect the public. The Securities and Exchange Commission is the proper Government organization to take the lead in this effort but it will have to be pressed to do so. The history of the accounting profession gives little hope that the accountants and their Financial Accounting Standards Board, if left to its own devices, will do a proper job.

Mr. MAHON. Admiral, you were responsible for bringing congressional attention to the need for legislation establishing the Cost Accounting Standards Board. How is the Cost Accounting Standards Board doing?

Admiral RICKOVER. The Board is doing good work in a number of areas; however, the pace of the Board's efforts should increase. In 3 years of operation only seven standards have been issued. That is not fast enough.

Acceptance of cost accounting standards is spreading within the Government, among nondefense agencies, and among some of the States. Some contractors have admitted receiving benefits from completing the disclosure statement. Others have submitted completed disclosure statements although they were not required to do so. Disclosure statements were received from about 900 operating units of 90 companies under the initial threshold of $30 million; a reduced threshold for disclosure is estimated to result in statements from an additional 400 to 500 units of an additional 85 companies.

The Board is currently considering a standard on depreciation of capital assets. Last October, I spoke to the Board on this subject and told them of my experiences with defense contractors' use of flexible depreciation guidelines. The Board is under pressure from industry to perpetuate this situation in which acceleration methods and service lives are established based on tax or financial incentive rather than cost. In the face of these pressures, the Board needs the continued support of Congress and others interested in establishment of uniform standards of accounting on defense contracts, so that Government money is not wasted.

Mr. MAHON. Do you have a copy of your remarks on depreciation that you could provide to the committee?

Admiral RICKOVER. Yes, sir, I will provide them for the record.

[The information referred to follows:]

[This statement reflects the views of the author and does not necessarily reflect the views of the Secretary of the Navy or the Department of the Navy]

OCTOBER 31, 1973.

STATEMENT TO THE COST ACCOUNTING STANDARDS BOARD CONCERNING A PROPOSAL TO ISSUE A COST ACCOUNTING STANDARD DEALING WITH DEPRECIATION OF TANGIBLE CAPITAL ASSETS

(By Vice Adm. H. G. Rickover, U.S. Navy)

You have asked me to talk about depreciation. One should not always feel it is incumbent on him to make some profound statement on a subject in which he is not an expert. I am not an expert in accounting, but I will try to give you some observations from my experience. I cannot refrain from also making some observations about your work during the past 2 years.

I have been honored to know your chairman, Elmer Staats, for a long time. He is one of the outstanding men in public life. The nature of his job, which he does with quiet distinction, denies him the public recognition his performance deserves.

As this Board surely knows, Government is not a bit of machinery that needs only to be properly fueled to run well. It needs clear direction. You are fortunate to have Mr. Staats' leadership in your important work.

When the Board first was established, I was concerned about the pressures which would be brought to undermine your work. Fortunately, you have an excellent staff and, in Mr. Schoenhaut, a competent executive secretary. So far you have done well:

You have fought off efforts to move the Board to the executive branch.

You have resisted pressures to include loopholes in the standards you have issued.

You have lowered the threshold for contractor disclosure statements from $30 to $10 million in negotiated defense prime contracts.

You are gaining a reputation as a competent and dedicated group. Although some defense contractors have criticized the Board for some of its decisions—as you could expect them to—I have never heard them question the competence of the Board or its fairness.

In a Government of large and frequently ineffective organizations, it is a pleasure to see your small group having a major impact. Although only part of your job has been done, you have already had a far-reaching effect. The requirement that defense contractors disclose their cost accounting practices and follow them consistently provides a basis for open and fair dealings with the Government. Even nondefense agencies have now invoked the Board's standards for their negotiated contracts. The idea of setting standards has spread also to the field of financial accounting, where the accounting profession recently established a full-time Financial Accounting Standards Board. I would hope that they face their challenges with the intelligence and dedication which characterizes your Board—and not become just a facade for the accounting "profession."

Reform does not come easily. It is easy to do nothing. It is easy to concentrate on attacking the symptoms, to seek short-term placebos. What is more difficult but essential is to review the system as a whole and to define—then insure—the conditions of its survival. You are doing this.

Although these are positive signs of your progress, I do have two recommendations:

First, I would like to see the pace of the Board pick up. To date you have issued only 5 cost accounting standards, and work is underway on an additional 12 or so areas. I had hoped you would be further along by now. You must guard against a tendency to study issues to death. Thought without action is not

worthwhile. There are many who would like nothing better than to see you tied up on issues which are not central to your work.

Second, you must not be overly concerned by complaints from industry. Industry will never be satisfied. Their opposition is compulsive and there is little reason for you to be overly persuaded by the predictable tone of anguish, no matter what your position might be.

I am not an accountant, nor am I prepared or qualified to debate the various theories put forth by accountants and industrialists. You are all experts in accounting and well versed in the traditional arguments. The accountants have had many years to wrestle with these questions and they often end up settling on whatever method of depreciation has been accepted for tax purposes. When I first talked with you shortly after the Board was formed in 1971, I said that a major accomplishment of the Board would be to establish rules for the application of accounting alternatives so that costs could be determined properly. Depreciation is an excellent example of an area where the available accounting alternatives can result in widely varying cost figures. It is the inevitable argument over the propriety and application of these accounting alternatives on defense contracts that makes it nearly impossible to tell how much defense equipment actually costs or how much profit contractors actually make in producing it.

A significant potential for distortion of cost stems from use of tax rules regarding method of depreciation and useful life of equipment. We all know that the tax rules result from a political process which considers social goals, financial incentives, and other factors. These tax rules are inappropriate for cost accounting. Mr. Staats made that point clearly in the General Accounting Office study on the feasibility of establishing cost accounting standards.

I have some observations based on my experiences with defense contractors over the past 35 years which are relevant to understanding why it is not good enough to let financial incentives govern depreciation decisions on defense work.

The first point is that competition in defense procurement is the exception, not the rule. Ninety percent of the defense procurement budget is spent in negotiated contracts where there is little or no effective competition. The complexity of defense work, the large start-up costs, the limited amount of business, the substantial advantage of a lead contractor in follow-on procurements—all make it difficult for new firms to enter the market. Exhortations to increase competition, new procurement policies, and the like, will not overcome these characteristics of the defense industry. You cannot expect competitive behavior in an industry which does not have a competitive structure. So, in setting a standard for the defense industry, you cannot presume that competition is an effective restraint on the contractors' financial decisions, such as those involving how fixed assets will be depreciated.

Your letter inviting me to this session included the statement that defense contractors use accelerated depreciation methods much more than those in commercial business. I think it is often to their benefit to do so. In a noncompetitive business such as the defense industry, where profit is based on estimated cost, the contractor is less constrained. The higher the cost, the higher the profit and, in the case of depreciation, the greater the cash flow. Profit should be the result, not the objective, of efficient management, but many defense contractors do not appear to understand this.

This brings me to my next point: Defense business today is concentrated among a few large contractors, many of which are conglomerates. Conglomerate policies on investment and cash flow have a major impact on depreciation policy. In many cases, they are reluctant to invest profits in new and improved facilities as long as higher maintenance costs can be passed to the Government. They do their best to increase return on investment by reducing investment in facilities. When forced to invest in new facilities, the higher depreciation costs under accelerated methods of depreciation help free up cash which can be used to acquire other firms or invest in other business ventures. These pressures—minimized investment and increased cash flow—have little to do with legitimate costs of defense work. And these pressures will not go away under conditions of limited competition. If we are to ascertain the legitimate costs of defense work with regard to depreciation, the cost accounting standard must require contractors to base depreciation policy on more realistic service lives and on the actual rate of use or deterioration, rather than on providing some artificial set of financial incentives.

Let me give you an example which illustrates the relevance of the two issues I have raised—lack of competition, and volume of defense business in the hands of conglomerates. Several years ago we tried to compare the cost of Poseidon

submarine conversions at two major shipyards. Since these contracts were negotiated with profit as a percentage of estimated cost in a noncompetitive situation, we found that the contractors were not paying much attention to reducing costs. In fact, the higher cost contractor was making the most profit. He had no incentive to improve his facilities or control their cost of maintenance to make them more efficient. For several years, his investment in facilities had been declining while his maintenance costs were increasing dramatically. The higher costs provided him a higher profit base. He could get away with this in defense business because there was little effective competition to hold prices down; we had to use both shipyards for the conversions and they both knew it. It is not surprising that under such conditions, cash flow and investment considerations outweigh those of efficiency and economy.

In case after case, we find contractor top management far removed from the day-to-day operations of the company. They are preoccupied with numbers at the bottom of a profit and loss statement and with how much cash they can generate from the operation. Those who do well by these standards are rewarded. When the manager runs into trouble, he is under great pressure to take advantage of whatever accounting flexibility there is at his disposal to portray his results in the most attractive possible terms, regardless of the impact on cost on Government work. Is it any wonder then that he focuses most of his attention on the financial aspects of the job? This is where your depreciation standard comes into play.

Let me now discuss two key issues on depreciation: Physical deterioration of assets and the issue of service life. I have heard contractors advance three major arguments for acceptance of accelerated depreciation. One is that equipment is consumed at a faster rate during earlier years of life, with the corollary that output declines later in life or that maintenance costs must increase and effectively offset the reduction in depreciation in later years. The second argument is that accelerated depreciation is a way of compensating defense contractors for the high risk inherent in the business. Finally, contractors argue that accelerated depreciation enables them to modernize plant, using the increased cash flow for investment in new plant.

I am involved primarily in manufacturing work where heavy machine tools are used. I have not observed the phenomenon of these machine tools wasting away faster in the early years. On the contrary, it is not at all unusual to find precision machine tools actively in use 30 to 40 years after they have been acquired.

I checked and found that every 5 years *American Machinist* publishes an inventory of machine tools in the United States. The results of the 1973 inventory have just been published. It shows that two-thirds of all machine tools in use by American industry are over 10 years old—28 percent are over 20 year old. Another revealing statistic is that three major types of metal working machinery—turning, boring, and drilling machines—have been getting relatively older for the past 30 years. For example, 66 percent of boring machines were under 10 years old in 1945, at the end of World War II. This was because of the large expansion of industry in the preceding 5 years. Now only 30 percent are less than 10 years old. These statistics on age of equipment in the U.S. machine tool inventory compare with Internal Revenue Service "guideline lives" of 12 years and IRS "asset depreciation range" minimum of 9½ years for companies in the "metal fabricating industry." The comparison shows clearly that the actual service lives of machine tools in the United States far exceed the service lives accepted for tax purposes.

The statistics on age of the machine tool inventory are backed by my experience. Rarely do I see contractors disposing of capital equipment at the end of guideline life. This would be wasteful. No contractor buys equipment he expects to be unable to use over a significant period of time. Of course, at some point, if a machine is used long enough, wear and tear make it less able to hold tolerance for precision work: errors in machining then increase the amount of rework and thus reduce output. But this phenomenon rarely occurs within the shorter service lives over which the equipment can be depreciated today and certainly not in the short time it takes to charge off the major part of the cost of an asset using accelerated depreciation.

The argument advanced by contractors that accelerated depreciation is necessary in consideration of risks in defense business is not valid in my view. More often the risks in defense work are greatly exaggerated. As I mentioned earlier, there is little effective competition for complex military equipment to

drive prices down. Most complex defense equipment is procured under cost-reimbursement or incentive-type contracts under which the Government bears a substantial portion or all the risk of cost overruns. From press accounts, you know that large defense contractors faced with financial problems often have been able to obtain financial assistance from the Government through claims, contract repricings, guaranteed loans, and the like.

The so-called market risks in defense procurement are also often exaggerated. In many cases, contractors perform major Government work in profit centers which are more certain of a continued market than are comparable profit centers in the competitive commercial world. Defense industry representatives often talk about the high degree of technological obsolescence in defense business. It is true there have been significant technological advancements in weapon systems themselves, but my experience has been that these advancements seldom make production facilities obsolete. In the majority of cases, components of new weapon systems can be manufactured using general purpose machine tools and production methods. Some items of specialized test equipment may become technologically obsolescent before the end of physical life, but in many cases these are not capitalized. I think you will find that most defense work is performed on general purpose machine tools which do not have a high degree of technological obsolescence and which can be used on defense or nondefense work to the end of their physical life. The concept of excessive market risk is not applicable for most large defense contractors.

Accelerated depreciation methods are based on cash flow, not risk. The contractor wants prompt cash flow. The procurement regulations allow it, and he would be foolish not to claim it. But cash flow considerations are not a sound basis for determining cost. I suggest that the Board should not accept as cost, depreciation amounts that are not in line with the expected rate of consumption of the asset.

Accelerated depreciation has not been an effective incentive to modernize defense plants, either. Often, in noncompetitive situations, contractors can optimize their cash flow and profits by not investing in capital improvements. Conglomerates can use the cash flow generated in their defense-oriented divisions to finance other corporate activities. In such cases, the defense work may absorb the high cost of accelerated depreciation, but the contractor uses the proceeds for nondefense work. On noncompetitive defense work, contractors may continue to operate older equipment beyond the point where it is economical to do so because they can pass on the higher costs to the Government through contract prices. I mentioned earlier that, since profits on defense contracts are negotiated as a percentage of estimated costs, the higher costs may actually result in higher profits in the long run.

The problem of unlimited repair and maintenance costs also needs attention. One approach would be to put limits on the allowability of repair costs. Another would be to exclude repair costs from the base on which profits are figured. But these are beyond the scope of this Board. What you can do is require contractors to account for repair costs in a way which will enable procurement officials to make judgments on reasonableness and refuse reimbursement for excess repairs unless adequate explanation is provided. I find that some defense contractors do not even keep cost records adequate to show when maintenance costs on major items of equipment have become excessive.

Some contractors also argue that, in an inflationary economy, fast write-offs generate the cash necessary to buy replacement equipment at higher price levels in later years. Obviously, in a period of rising prices, replacement equipment will cost more than the original. But the question before the Board is what is cost. It seems to me that depreciation cost should be whatever you actually paid for the asset rationally prorated over its useful life. The question of how contractors might finance possible future plant and equipment acquisitions is a separate issue which should not be factored into cost calculations on current contracts.

With regard to service life, I have noted that two-thirds of machine tools in the United States are over 10 years old. Yet service life "guidelines" used by the IRS permit equipment to be depreciated over shorted periods in many cases. For example, in the case of horizontal and vertical boring mills, the bread and butter equipment of many large manufacturing operations, IRS rules permit the asset to be depreciated over a period of as little as 9½ years by companies in the metal-fabricating industry. This is too short a life for such equipment.

There is also the issue of uniformity and comparability between two companies with the same type of assets. As I understand the present cost accounting

situation—which is based on IRS rules—there is no requirement that plants doing identical work should use similar depreciation charges.

For example, several years ago, one of our suppliers decided to invest in more machine tools. He proposed to depreciate them over an 8-year life rather than the 12-year life other suppliers, doing, identical work, had told us was the minimum service life accepted by IRS for that type of equipment. He assured us the 8-year life was acceptable under IRS guidelines. We checked and found that apparently he was right. The difference between the 8-year service life he could use and the 12-year life used by other manufacturers is that his parent corporation was classified in a different industry grouping where a more favorable "guideline" was available to him than to his competitors. Under procurement regulations, he could use the shorter service lives.

A second example concerns a private shipbuilder who, under IRS rules, was writing off the cost of a dry dock in 12 years. In contrast, another shipyard in the same line of work was depreciating its dry dock on a straight line basis over 40 years. As a result, depreciation charged on identical jobs done by each shipyard varied significantly—$200,000 per year for the company using straight line over a more realistic life, and $1.2 million for the company proposing accelerated depreciation over a very short life. There is little wear to a dry dock and it is not uncommon to find dry docks 50 to 100 years old still in use. In this case, we finally got the company to agree to write the dry dock off over a 20-year life for contract purposes, but this is still much less than its economic life.

Accountants permit the two managements to make different estimates of service life and to use different methods of assigning the cost over the different time periods. With that kind of "flexibility," how do you expect a program manager to make sense out of cost estimates from two contractors?

I appreciate the difficulty of establishing accurate service lives, yet it should be done. You ought to be able to devise simple statistical tests whereby those contractors who continually understate service lives are required to make longer estimates for their write-offs. Since standards for usable lives should be uniform, there may be cases where equipment will have longer or shorter lives than what is established in your standard. For the sake of equity, the Board probably will have to lean toward underestimating actual economic lives. Even so, if you are to arrive at a depreciation standard that fairly represents actual costs, realistic lives for depreciable equipment should be substantially longer than presently permitted by IRS for tax purposes. I hope you will provide rules that make similar circumstances lead to similar depreciation charges.

I wish I could express complete confidence in contractors and their accountants on the question of service life. But they do not appear to be trying to estimate actual service lives. Contractors are trying to justify short lives, and the public accountants seem to condone the practice. Accountants have a mania for measurement—the uncertainty is the yardstick they use. All too often their sophisticated calculations are based on simple false assumptions.

Let me summarize my main points:

(1) Tax rules are not adequate for cost accounting in depreciation of fixed assets;

(2) The absence of effective competition in much of the defense industry results in depreciation charges based mainly on the desire for prompt cash payment;

(3) There is no justification in my experience for accelerated depreciation as the basis for cost accounting;

(4) There is no evidence that machines deteriorate at a rate even approaching their depreciation under an accelerated method;

(5) Comparability between contractors doing similar work should be required; and

(6) You should face up to the issue of service life, and establish standards which come closer to actual service life than the current tax regulations.

These are important issues which deserve your careful attention. Nevertheless, the work of this Board must also be viewed in a broader perspective: it must include the role of accounting and the role of business in our society. We are faced today with the large question of which type of society—the totalitarian or our democratic capitalist one—will predominate.

The totalitarian ethic is based upon the assumption of a sole and exclusive truth. It postulates a preordained harmonious and perfect scheme of things to which men are presumed to be irresistibly driven.

Our system finds the essence of freedom in spontaneity and in the absence of coercion; theirs believes it will be realized only in the pursuit and attainment of an absolute collective purpose. The aims of our system cannot be realized

through coercion. We consider the use of force for their realization to be an evil. We believe that in the absence of coercion we will one day reach, through a process of trial and error, a state of harmony.

Public opinion polls reflect the low regard in which the people hold business in America. These polls indicate an increasing public cynicism about the capacity of business to put its house in order.

Or capitalist system is under attack. In large areas of the world it is no longer used. Elsewhere, such as in parts of Western Europe, it has become subject to extensive Government control.

I believe in our capitalist system. I believe in competition. Business has a right to, and should make, a profit. It is to their best interest to avoid practices for which they have rightly been criticized. Business must not ignore its shortcomings nor attempt to explain them away.

Should our capitalist system be destroyed, it will be accompanied by the destruction of most of our liberties. Therefore, for its own good as well as for the good of the people of our country, business must put its house in order.

The so-called "profession" of accounting, because of its active participation, must share the blame for the state of our business morality. The difficulty in obtaining reliable and consistent information from company annual reports—with their calibrated phrasing—is but one example. A calling, to merit the name of "profession," must live up to a code of ethics and enforce that code on its members. On these terms, is accounting a profession? Accounting is presently self-governed, not because of any natural or constitutional right but because of public consent. Society considers itself without the necessary knowledge and expertise to review the quality of professional service or to evaluate professional judgments. If accountants do not start policing themselves the public will withdraw its consent and accountants should not be surprised one day to find an official-looking stranger scouring out their house with a detached and ruthless thoroughness.

I know that the task of the Board is complex, and that my suggestions cannot be adopted easily. Many in Government as well as industry are strongly motivated not to solve the problems they face because the solutions might interfere with their concepts. Some tend to adhere to abstract theory and to ignore immediately relevant problems. Others view solutions as endangering familiar ways of doing things.

As this Board has already demonstrated, it is not so much the ability, the diligence, and the hewing to the problems that are necessary. It is loyalty, intelligence, perspective, judgment, and selflessness. You must continue to be zealots—not for a cause but for facts and for truth. Today is a time of new beginnings, a time of discovery. But it is also a time for developing better ways of managing what we have and of completing what man has begun.

To understand is easy; to do is difficult. We are all imperfect in our endeavors, and we may be forgiven if we have done our best and advanced but little. In the light of the problem of survival of our democratic capitalism as well as our individual liberties, what you are doing serves a large national purpose.

(Excerpt from hearings before Seapower Subcommittee of House Armed Services Committee, 23 September, 1974. Admiral Rickover was being questioned by Rep. Patricia Schroeder of Colorado.)

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Shipbuilders' Annual Financial Reports

Mrs. Schroeder. You have talked a lot of the time about the reports of industrial companies in their financial reports.

Do you find this a lot different from what they are reporting to their stockholders?

Admiral Rickover. No, the two reports are the same. But what I do find is that the figures reported to the Navy and to stockholders are subject to manipulation, and cannot be relied on. For example, this committee has heard a lot of testimony from shipyard executives

to the effect that, on Navy work at least, profits are low and going lower. The Navy hears the same complaint. Many reasons are cited for the low profits. But what is not mentioned is how these profits are calculated, and how accurate the figures are. A little reading between the lines can be enlightening.

Presumably the figures the executives are quoting are taken from financial data, such as annual reports, which are prepared for stockholders. The financial information revealed in these reports is relied on by both investors and creditors. It also plays an important role in defense procurement, as you are witnessing. Defense contractors cite figures from their annual reports in efforts to negotiate higher profits on new orders, to obtain better claim settlements, or to change defense procurement policy. There is a tendency among some defense officials to accept these figures without question, not recognizing that neither the Navy nor the Defense Contract Audit Agency is given access to the financial books and records that would enable them to verify these numbers.

Given the importance of corporate annual reports to the economy as a whole, and also to defense procurement, one would expect that the figures in these reports accurately reflect the results of a company's operations and its financial condition. I find that little credence can be placed on these figures. Companies have great latitude in how they account for costs and profits for financial accounting purposes. As a result, the figures are susceptible to manipulation and judgments which can dramatically change reported profits—all within the constraints of the so-called "generally accepted accounting principles."

Percentage of Completion Accounting

Shipbuilding contracts may take 5 years or more to complete. Under the so-called percentage of completion method of accounting for profits and losses on long-term contracts, contractors have the accounting flexibility to convert sizable losses into respectable profits or vice versa on an annual basis, simply by changing management estimates of progress and contract revenues. These company judgments are not subject to strict audit verification even by the company's independent auditors. When a contract is completed and the actual profit and loss is determined and appropriate adjustments made, shipbuilders can still mitigate the impact of the actual profits or losses by adjusting the profit estimates on the yet uncompleted work.

Here are some specific examples of what I am talking about.

A conglomerate acquired a shipbuilding company 8 months into the fiscal year. For the first 8 months before the conglomerate took over, the shipyard reported a $28.9 million loss, although it had reported respectable profits in prior years. For the remaining 4 months of the year, under the conglomerate management, the shipyard reported $4.4 million profit. That shipyard division then showed record high profits for the 2 following years, and a relatively stable high profit for the third year, before profits began to decline. The conglomerate did not really institute many significant changes in the shipyard. By and large the work was done by the same people, following roughly the same procedures. However, the profit reports indicated that conglomerate management had once again turned an unprofitable operation into a profitable one. The question arises whether the large

writeoff prior to acquisition by the conglomerate was realistic and whether the profit projections for the next few years were overly optimistic. If so, they would ultimately have to be corrected by reported losses as contracts are completed.

In some cases, contractors predicate their profit figures on the favorable outcome of claims under litigation with the Government. Yet, the reader of the financial report has no way of knowing whether management's estimate of the expected amount from claims is conservative or wildly optimistic. One contractor has already booked over $56 million for claims on which he expects to be paid. Yet these claims are still being litigated, and the Government has offered the contractor about one-third of the amount booked. The average investor could not learn this fact by reading the annual report.

Flexible Accounting Practices

One defense contractor has four different methods of recording his current year contract profits and revenues. The particular method he chooses to use depends on the actual profitability of the contract. So you see, a contractor can calculate his reported profits in a number of ways, and these calculations may even differ from contract to contract.

Early this year, one contractor reported to the Government the financial results of his 1973 operations. A month later, he revised both his sales and profit figures downward by several millions of dollars. The company could have arrived at almost any figure it desired simply by changing estimates.

Reported figures, certified by a public accounting firm, convey the impression of precision and frequently are represented in that vein. But the truth of the matter is that these figures are to a great extent subject to the desires of management.

A note in one company's annual report mentioned that the total cost estimates used to determine ultimate profitability on its Government contracts included more than $100 million of nonrecurring manufacturing costs associated with a new facility. It appears that this amount actually represents losses incurred by the contractor on previous contracts for nondefense customers. So here is a case where reported profits in a given year could vary by many millions of dollars upward or downward, depending on whether management elects to write off the losses as they occur or to amortize them over future business as nonrecurring manufacturing cost. A management decision as to how certain costs are handled can thus have a big impact on a company's reported profits.

Another contractor had his profit reduced by $4.2 million a year simply because his share of the parent corporation's expenses was retroactively increased by a factor of 20. And flexibility doesn't stop here. If the corporation had wished, it could have reduced the defense subsidiary's share of these costs, and consequently increased the profits for the year.

The fact is, the low profits reported by shipyard executives are suspect if only because the present methods of financial accounting are so flexible under generally accepted accounting principles. In addition, because contractors do not generally make their profit calculations available for Government review, the Navy cannot verify the validity of these shipbuilder profit figures.

Of course, the shipbuilders face a dilemma. In talking to defense officials or to you, they emphasize poor profits on Navy work to see if they can get the profit levels increased. In dealing with stockholders through their financial reports, however, their incentive is to report the company as well-managed and operating profitably. The same situation is true with respect to cash flow problems. Shipbuilders enjoy more favorable progress payments than other segments of defense industry. Yet they are eager to talk about their tremendous cash flow problems. However, they are unwilling to make records available to show the magnitude of the problem or to what extent it is caused by Navy work, or commercial work, or failure to make adequate progress as required by the contract.

In short then, Members of Congress and defense officials both should not place credence in unverified financial data provided by shipbuilders or other contractors.

Need for Accurate Financial Reporting

Mrs. Schroeder. One of the things I wondered about, I know in the Postal Service, which is the only thing I can think of that is kind of analogous, we have rules. Now it is supposedly private but they must assign their overhead in accordance with each percentage of the class of mail. Specific accounting standards are written into the statute. We don't have that there?

Admiral Rickover. No, Mrs. Schroeder, we do not. I think the area of accurate financial reporting by all companies is an area where Congress should step in and provide a set of rules which would require all of them to report their financial condition on a consistent basis. Congress frequently has to get into problems that arise out of inaccurate reporting. You recall how accounting flexibility led to the unfortunate situation with Penn Central. You also recall how, because of the inaccurate financial reporting, the public had no advance warning of that company's financial problems until it was too late. I think the public is waking up to the fact that the existing rules are not serving their best interests.

Public accountants are supposed to be watch dogs against attempts by companies to provide unreliable or inaccurate financial data. But, because they are hired by the companies themselves, they are under intense pressure to go along with the companies' accounting of the year's operation lest they lose the companies to a competitor. Neither the Accounting Principles Board nor the Financial Accounting Standards Board has been willing to step in and establish the necessary standards that are so sorely needed.

The Securities and Exchange Commission must also bear responsibility for the current problems in financial accounting. However, they are beginning to show more concern. They have proposed two amendments to their rules for accounting on contracts. The first proposal would require companies to provide greater disclosure in connection with inventories and accounts receivable on long-term contracts. The second proposal would increase the independence of public accountants from the firms they audit. These proposals are a step in the right direction. But I predict they will meet stiff opposition from defense contractors and other industries involved in long-term contracts.

Industry pressure will probably result in these proposals being watered down or dropped.

As you know I was partly responsible for the enactment of the law establishing the Cost Accounting Standards Board. This Board is beginning to have some effect on cost accounting for Government contracts. Unfortunately, their standards and rules will not have much of an effect on financial accounting. I believe Congress is going to have to take an active interest in the field of financial accounting just as it did in the field of cost accounting to see that standards are developed that will adequately protect the public.

The point here is that it is not right for companies to be permitted to present financial reports that are not factual. The same holds true in the case of claims. I can give you an example if you like.

Mrs. Schroeder. I would like that.

* * * * * * *

OVERSIGHT OF THE RENEGOTIATION ACT

THURSDAY, JUNE 12, 1975

House of Representatives, Subcommittee on General Oversight and Renegotiation of the Committee on Banking, Currency and Housing
Washington, D.C.

* * * * * * *

Mr. Rickover. * * *

In the case of many large defense contractors, the Renegotiation Board reviews contractor profit estimates, not actual profits Ship-

builders, for example, calculate sales and profits on long-term contracts by the percentage of completion method of accounting. Under this method, contractors have the accounting flexibility to convert sizeable losses into respectable profits, or vice versa annually, simply by changing management estimates of progress, cost at completion, and contract revenues.

Each year, the company recognizes a percentage of the estimated final profit for the contract, based on its own estimates of final cost and revenues, and what work was completed during the year. These company judgments are not subject to strict audit verification, even by independent certified accountants. Further, when a contract is completed and the contractor is faced with an actual profit or loss figure, he can adjust his profit estimates on uncompleted work to achieve the desired financial results for that year.

I will give you an actual example of how profit figures on a single contract can vary drastically from year to year under percentage of completion accounting, and why profit figures reported by contractors cannot be accepted at face value. The table you have in front of you covers from 1970 to 1974 for one company on one contract.

[The table referred to follows:]

[In millions]

	Contractor [1]	Annual profit [2]
Year:		
1970	$10.3	$2.4
1971	9.7	2.7
1972	.8	(5.1)
1973	(3.5)	(4.1)
1974	7.0	10.5

[1] Contractor's estimate of profit at completion of the contract.
[2] Annual profit (loss) reported for this contract.

In 1972, the contractor predicted he would make a small profit upon completion of the contract. But since he had already reported more profit in the previous 2 years than he expected to make on the entire contract, he had to correct the record by reporting a $5.1-million loss in 1972. Thus, although the contractor predicted he would make a profit upon completion of the contract, he reported a $5-million loss in 1972 to the Renegotiation Board. In 1974, he did the opposite. He estimated a $7-million profit on the contract at completion. Yet, to compensate for losses reported in prior year, he reported for 1974 a $10.5-million profit—$3.5 million more than the total profit he was projecting for the complete contract. This is the kind of gimmickry you run into all the time. A contractor can just juggle these figures around so as to avoid renegotiation.

There may be valid reasons for the variations in the contractor's estimates. But notice how percentage of completion accounting distorts the annual profit figures reviewed by the Renegotiation Board. It takes little imagination to see how, in a system like this, the contractor's estimates of current year profitability could be influenced by what figures he wants to report to the Renegotiation Board.

This example is not an isolated case. One contractor reported to his corporate headquarters and to the Government his financial results for the previous fiscal year. A month later, he revised his sales and profit figures downward by $6 million. The company could have arrived at almost any figure by simply changing its estimates. Another contractor used four different methods of recording his current year contract profits and revenues on four different contracts. These four methods are all variations of percentage of completion accounting, but the estimates are constructed so that in cases of cost overruns, his financial reports to the public do not have to show a loss. And because these figures are estimates, they cannot be verified effectively by independent auditors.

I think the Securities and Exchange Commission is beginning to take some account of how the public is being fooled by these reports of corporations. It is requiring greater financial disclosure on defense and other long-term contracts. But the problem of financial disclosure affects all of industry. I think companies should be required to adopt financial accounting standards somewhat like the standards of the Cost Accounting Standards Board, so that the public is not given false or misleading information, and does not invest their money on false premises.

The flexibility inherent in percentage of completion accounting is presently tolerated for tax or financial reporting purposes, but it is unacceptable for renegotiation purposes. Under this system, where annual profit figures are only profit estimates, contractors can simply shift profits from one year to the next, from a good year to a bad year. By tailoring his profit reports to the Renegotiation Board in this way a contractor may avoid excessive profit determinations altogether.

*   *   *   *   *   *   *

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September 1, 1976

TO WHOM IT MAY CONCERN:

This is to confirm events and circumstances in the case of my firm, in which we have been the object of major accounting firm client acquisition attack.

Since 1952, we had and developed into a major client situation covering a full range of services, a relationship with a large Japanese company, through its U. S. affiliate. By 1973, this client had come to represent more than 30% of our annual practice. For some four years prior thereto, we were given indications, casual comments and hints that some of the so-called "Big 8" accounting firms had made strong approaches to take over this situation. We were unable to identify the firms involved.

After we were well into the audit for the fiscal year ended January 31, 1973, we were advised by the then President and Managing Director that the parent company in Japan had retained one of the "Big 8" firms to replace us. He advised us that this had nothing to do with the quality and extent of our services, which he lauded highly. In fact, upon completion of that engagement, we were all invited to a farewell dinner by the senior management and the senior accounting staff, expressing great regret over our displacement.

Having pressed the managing director privately for an explanation, he advised that the "Big 8" firm had been campaigning actively for this business, principally by asserting "they could control the actions of the Japanese tax office to our advantage". This, of course, is hearsay, but not irresponsble chatter from such an important and knowledgable source.

Since that time, the Managing Director has been recalled to Japan (he had been Managing Director from 1952 through 1973).

On other occasions, when we would be asked to discuss the accounting work on SEC registrations, we were mostly unsuccessful if a "Big 8" firm was in competition. We ascribed this to their strong "hold" on brokers and underwriters. But in more than one case, they underbid our estimates at the outset, and then billed large extras later on, before completion of the engagements. In one particular instance involving another national accounting firm in connection with a small issue (between $400,000 and $550,000) we quoted approximately $7,500 <u>including</u> any time in Washington to resolve adverse deficiency notices, etc. They quoted "under $5,000", but billed a total of "over $12,000" by the time the engagement was completed. Our source was the then financial officer of the company, who is no longer with them and who had been previously associated with us.

In another case, where the writer was a partner of an accounting firm, an engagement he was managing became a "problem" because the client's financial statements could not be accompanied by a "clear opinion" without significant changes. A national firm took over this matter and furnished the opinion we would not furnish without the changes we felt were required.

The purpose of this letter is to provide some background, out of our own experience, as to how the so-called "Big 8" firms operate, and how smaller accounting firms are being driven out of larger and more lucrative engagements. Nothing has been said herein about displacement of smaller accounting firms upon acquisition of smaller business firms by larger ones, but this happens continuously, too. This, however, is more understandable than the direct attack, the low-ball price bid, and the continuous propaganda that all the small firms are either not competent, or unacceptable to the financial community.

Norman J. Elliott, CPA
(New York and Pennsylvania)

NJE:mmh

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New York / Great Neck, New York / Miami
Washington, D.C. / Columbus, Ohio

March 31, 1976

Senator Alan Cranston
Room 452
Senate Office Building
Washington, D. C. 20510

Dear Alan:

It has been brought to my attention that Senator Metcalf, as Chairman of the Senate Sub-Committee on Reports, Accounting and Management, is making some sort of investigation as to the anti-competitive activities of some of the larger international accounting firms.

If such enquiry is being conducted, we would be interested in the status and would like to do whatever we can to encourage the Senator in this endeavor. We, as a firm of practicing CPA's, have continually advised the accounting professions' senior bodies of our belief that the so-called 'big 8' national firms were engaging in anti-competitive activities. We have accumulated some material to support our position.

Very truly yours,

Kenneth Leventhal

KL/j

United States Senate

COMMITTEE ON
GOVERNMENT OPERATIONS
SUBCOMMITTEE ON REPORTS,
ACCOUNTING, AND MANAGEMENT
(PURSUANT TO SEC. 7, S. RES. 363, 94TH CONGRESS)
WASHINGTON, D.C. 20510

4 June 1976

Mr. Kenneth Leventhal
Kenneth Leventhal & Company
2049 Century Park East
Los Angeles, California 90067

Dear Mr. Leventhal:

As part of its accounting responsibilities this subcommittee is currently studying the structure of the accounting profession and its relationship to Federal agencies. Senator Cranston has forwarded to me your letter of 31 March to him regarding your firm's concern over anti-competitive activities by the big eight accounting firms.

In order to obtain some relevant information, a questionnaire was mailed to the big eight firms by this subcommittee on 19 Decmmber, 1975. A copy of the questionnaire is enclosed for your information.

Our conversations with other accounting firms and practitioners have indicated a general concern within the accounting profession over the activities of the big eight firms and the manner in which those activities effect the accounting profession. Your letter states that you have materials to support a charge of anti-competitive activities against the big eight firms.

We welcome any materials or views you have which may help us in our study. As we are operating under some time constraints, however, I ask that you provide us with any submissions within two weeks so that we may fully benefit from your views.

Very truly yours,

ORIGINAL SIGNED BY
LEE METCALF

Enclosure

AICPA
American Institute of Certified Public Accountants
666 Fifth Avenue New York New York 10019 (212) 5?1-?4?0

September 17, 1974

Norman H. Stavisky, CPA
Stavisky & Shapiro
141 Milk Street
Boston, Massachusetts 02109

Dear Norman:

Now that the Institute's 1973-74 committee year is drawing to a close, I want to express my appreciation--and Chairman of the Board Sam Derieux has asked me to add his--for the time and energy you have contributed to our group.

As you know, the committee has completed its current projects, namely:

1. Revision of the "Going Public" pamphlet.

2. Survey of investment bankers willing to use competent non-national firms in initial registrations.

3. Completion of the article for the Journal of Accountancy which summarizes the committee's achievements.

4. Survey of national firm policies regarding their assistance for initial registrations to firms less experienced in SEC work.

5. Obtaining and making available to members SEC prepared computer runs that indicate the accountants and underwriters involved in initial registrations.

6. Interviewing various SEC and stock exchange personnel for the purpose of obtaining their views on the displacement problem.

With the completion of these projects, the committee has effectively dealt with all the matters with which it was originally charged.

As we discussed at our last committee meeting, any possible new projects appear to either overlap with the duties of other Institute committees, or involve problems that defy complete or foreseeable solution by their nature. Therefore, considering the limited likelihood of further significant contributions in this area, it was decided with my concurrence, that the Displacement of CPA Firms Committee be discontinued in the coming year.

I have enjoyed serving on this committee with you, undoubtedly you share my feelings that we have done a commendable job and that our efforts achieved the results we expected.

Again, Norman, thank you for your help.

Sincerely,

Bob

Robert Coffman
Chairman
Committee on Displacement of
CPA Firms

RC:kh

July 14, 1976

To Whom It May Concern

From: Norman H. Stavisky, CPA

Re: Committee on Displacement of CPA Firms of the American Institute of Certified Public Accountants

I was a member of the above committee in its final, and greatly abbreviated, year of operations. The activities of this committee were carefully regulated by Mr. William C. Bruschi, Vice President of the AICPA staff. The major accomplishment of this committee was the very minor revision of the Institute's "Going Public" pamphlet.

What turned out to be the committee's final meeting was held on April 8, 1974. Mr. Robert M. Coffman, the Chairman of this committee, did not attend this meeting, and so Mr. Bruschi ran the proceedings. Since the "Going Public" pamphlet was ready for printing and an article lauding the negligible activities of this committee was being prepared by the Institute's staff, we discussed each other area where our committee could aid the non-national accountants being displaced in areas other than SEC matters. On each and every item where the members of our committee felt that we could be of service to the non-national members of the Institute, Mr. Bruschi stated that these future activities could overlap with the work of other committees, and, therefore, he could not allow their being undertaken. We left the Institute's offices in Washington, D.C. having accomplished extremely little and seeing the committee disbanded as having completed its current (acceptable) projects.

I am enclosing a copy of a letter sent to me by Bob Coffman dated September 17, 1974 explaining once again the Institute's position that our committee be discontinued in the coming year. In no way do I share Mr. Coffman's feeling that the committee performed a commendable job, nor do I see where our minimal efforts achieved any significant results that might have been expected by the Institute's non-national membership.

Norman H. Stavisky

ROBERT HALF PERSONNEL AGENCIES, INC.
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September 20, 1976

Hon. Lee Metcalf, Chairman
Reports, Accounting and
Management Subcommittee
Government Operations Committee
United States Senate
Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Metcalf:

I am pleased to respond to your request for information regarding the personnel placement activities of large public accounting firms.

I am the president of Robert Half Personnel Agencies, Inc. In its 28 years of operation we have filled thousands of positions in the Financial and related Data Processing fields, throughout the world. I also head a franchise company which operates over 50 similar offices in the United States, Canada and Great Britain. In addition, I am a Certified Public Accountant. I believe this background provides me with adequate experience and perspective to furnish the information you require.

Although I am a CPA, I do not practice accounting. I am prohibited from practicing as a public accountant, as a result of affidavits that I was required to sign by the American Institute of Certified Public Accountants and the New York State Society of Certified Public Accountants. Both organizations believed my involvement in the profession would constitute a conflict of interest and competition to CPA firms.

I have not been in the accounting field these last 28 years. I have no intention of returning to it. However, it would be interesting to know the attitude of the trade associations if I elected to return to accounting, in the light of substantial and ever increasing participation of the major public accounting firms in my industry. The AICPA and the State Society were right. There would be the appearance if not indeed the actuality, of a conflict of interest. I would not permit such a dual and conflicting involvement.

A Dictionary for Accountants defines conflict of interest, in part as follows:

> "A conflict of interest may be asserted, even where no material benefit is involved, no added cost or loss of profit is in prospect for the employer, or the relationship is known to stockholders or owners; the <u>mere possibility of a benefit accruing to the individual at some indefinite future time is enough to justify the assertion.</u>" (emphasis supplied).

Business Week, April 14, 1973, in an article entitled "Conflict of interest; The moral climate changes" states, in part:

"It may take years for investigators to determine what went wrongat Equity Funding Corp. of America, the scandalridden West Coast financial conglomerate. What the investigators, from the Securities & Exchange Commission and a federal court, fear they will uncover, though, is a conflict of interest on a truly massive scale that stretches from the possible misuse of insider information to out-and-out fraud by some Equity Funding executives.

The Equity Funding case may be grabbing the headlines, but it is only the latest in a long - and increasing - list of conflicts that have involved major companies. American Airlines, Kaiser Industries, the Penn Central, Merrill Lynch and the Nashville brokerage house of J.C. Bradford & Co. - to name just a few - have all had to deal with conflicts in the past few years.

There are more conflicts because of the sheer complexity of business, and the increasing complexity of a company's relationship with its directors, stockholders, the government, and the world at large. At various times, conflicts, real or potential, can involve banks vs. their customers, accountants vs. their clients, and even companies vs. the public. Most conflicts never come to light, but corporate executives interviewed by Business Week nationwide agree that there is a record number of cases today.

It is also true that conflicts of interest appear more frequently because more people are watching for them, and because the definition of what constitutes a conflict has broadened considerably. What was routine a generation ago may be a conflict today.

"We're noticing conflicts more now because the public, the press, and the SEC are emphasizing them more," says Robert Kay, director of accounting and professional standards for Touche Ross & Co., the accounting firm. "The morals of business aren't changing," he says. "The ground rules are. There's a demnad for lily-white hands."

In view of the foregoing, is it a conflict of interest when key employees, placed by a public accounting firm at a client, fear their positions could be endangered by disagreement with outside accountants? The AICPA Code of Ethics states:

"The CPA must be alert to the possibility that undue identification with the management of the client or

involvement with a client's affairs to such a degree as to place him virtually in the position of being an employee, may impair the appearance of independence."

Is it a conflict of interest when key employees, who were former staff personnel at the public accounting firm, are transferred to the client? Is this employee's first allegiance to the accounting firm? To the public? To the SEC? To the stockholders? Is it not possible to justify an assertion of conflict?

Should the SEC take positive action to prevent conspiracies?

On March 26, 1968, Mr. Philip A. Loomis, Jr., General Counsel to the SEC responded to an inquiry from my attorney, Mr. A. Bernard Frechtman. I quote, in part:

> "We know of no instance where financial statements filed with the Commission have been shown to be in any way defective because of the recruiting activities of the accountant who certified them. On the other hand, our Chairman expressed some concern with this practice in a speech of October 1966 which is published in the December 1966 issue of The Journal of Accountancy commencing at page 56.
>
> Under the circumstances, while it is possible that such recruiting activities could indirectly lead to problems in a particular case, I am not in a position to express a broad across-the board opinion either way, particularly as a matter of legal interpretation of the statutes and rules administered by the Commission."

Dr. Abraham J. Briloff, in his recent book, "More Debits than Credits", cited the National Student Marketing case. He indicated, Anthony M. Natelli, a Peat, Marwick, Mitchell & Co., partner, and Joseph Scansaroli, employed by PMM until September or October 1969, when he became the Assistant Controller of NSM. "On or about September 27, 1969...Anthony M. Natelli and Joseph Scansaroli as independent auditors of NSMC, unlawfully, willfully, and knowingly made and caused to be made false and misleading statements with respect to material facts...in a proxy statement for NSMC dated September 27, 1969," On appeal in the U.S. Circuit Court of Appeals, the conviction of the PMM partner was upheld, that of Joseph Scansaroli was reversed and a new trial ordered. Subsequently, Scansaroli's conviction was also affirmed.

Can it not be assumed one of the reasons for hiring Mr. Scansaroli was to make for a better atmosphere to perpetrate a fraud?

Is it a conflict of interest if executive recruiting is only a minor part of a public accounting practice? The following is a quote, dated October 3, 1969 from AICPA FINAL REPORT OF AD HOC COMMITTEE ON INDEPENDENCE:

> "However, such services as psychological testing, public opinion polls, or executive recruiting pose a different problem. Such services are rendered by relatively few firms, and represent only a very minor part of the management services rendered even by them."

The Journal of Accountancy (the official organ of the AICPA), March 1975, in an article entitled "Nationwide MAS Surveys" conducted by the Roper Organization, reflected, that of the 50 firms reporting, 35% of them expected a lot or a moderate amount of anticipated market growth in executive and managerial recruitment. Does this growth appear to be minor?

Another important factor to be considered in this connection is that employment agencies are licensed. The licensing is administered usually by the State Department of Labor or Consumer Affairs. Some states require public accounting firms to be licensed as employment agencies. And they are. Is there not a possible conflict between the myriad and complex licensing laws governing employment agencies and their regulation, and the canons of ethics of accounting?

The AICPAs "SUMMARIES OF ETHICS RULINGS 8/70", states:

> "CPA TITLE ON EMPLOYMENT AGENCY LETTERHEAD
>
> Q. A nonpracticing member established an employment agency for accountants. His stationery carries his CPA title. Is this a violation of the Code?
>
> A. There would be no violation since the member is not in the practice of public accounting."

Aren't the names of the major public accounting firms synonomous with CPA? And conversely, wouldn't most people when asked to name a CPA firm mention one of the giants? Is it really important whether or not the CPA designation is actually used if the implication is clearly there?

Can a CPA firm 'pirate' an employee from a non-client in a dignified way? Can a CPA firm have reason to believe the executives are available? In the AICPAs "SUMMARY OF ETHICS RULING 8/70", they think it's logical, when they said:

"EXECUTIVE SEARCH

Q. Is it permissible under the Code of Ethics for a CPA who has undertaken an executive search assignment to make unsolicited telephone calls or other overtures to executives of clients of other CPA firms (who he has not met) endeavoring to interest them in the job opportunity?

A. As long as it is done in a dignified manner, CPAs can approach executives of clients of other CPA firms when they believe the executives to be available and qualified and are endeavoring to interest them in a position with an executive search client."

It is a violation of professional conduct to render services to a non-client. The theory, of course, is that it is unethical to solicit for clients. Is it not, therefore, a conflict of interest if the public assumes that this is happening? In reality it is. In Auren Uris' book, ACTION GUIDE FOR EXECUTIVE JOB SEEKERS, he has a section on Executive Search, titled "Case History of an Accounting Firm". I quote, in part:

> "Eventually the requests for executives came not only from clients, but from a number of companies that had heard of the accounting firm's placement activities. The firm then decided to formalize its recruiting operation and set up a separate department under the guidance of Mathew J. Beecher, whose sole function was executive placement. In the past several years, Beecher has made over sixty placements a year just from P.W.'s New York office. The executive placement activity has three benefits for Price Waterhouse: it serves client's needs; it helps establish good relations with the business community as a whole, it enhances the firm's reputation for service and brings in many new friends."

The Uris book was copyrighted in 1965. Since then, the growth of placement activities amongst the large CPA firms has been phenomenal.

The AICPA Code of Ethics states:

> "A member, while practicing public accounting, may not engage in a business or occupation which is incompatible therewith."

Is the placement of marketing personnel compatible? I quote from the resume of a large CPA firm recruiter looking to change jobs:

"Responsible for identifying, evaluating and selecting candidates for client executive positions in marketing, financial, manufacturing, administrative and general management functions."

This recruiter was not an accountant. He had a degree in engineering and another one in foreign trade.

Personnel recruiting by major CPA firms is no longer a minor part of their business. The fact is its growth has been astronomical, and has monopolistic overtures. The top 8 public accounting firms in the United States have substantially all of the large clients in the country. The large CPA firms, by the process of mergers, are getting bigger, and the medium size firms are becoming fewer in number. The logical conclusion is that if all of the large firms capture most of the executive and semi-executive placement business in the country, there will be no place for an applicant for employment to go except to one of the big eight firms. After all, the CPA firm has the first 'crack' at the openings since they are always in contact with their clients discussing other matters.

But that is not the only problem the job-seeker has in looking for a position when one of the major firms is conducting the search. An important part of the public accounting firm searches is a 'blind ad' (a box number). These ads do not usually indicate they are being screened by a CPA firm. They appear to be the company's own ad. Traditionally these ads end with, "Our employees know of this ad." Which employees? The accounting firms? The client's? The chances are that only one, or at the most a few top level employees know of the search. What happens when an employed applicant answers a blind ad and the response goes to the accounting firm? If this applicant is large firm oriented, the chance could be nearly one out of eight that the response will be received by the same accounting firm that does the audit in the firm he's working for. Consider the consequences for that applicant and the question of conflict for the accounting firm.

What is the logical conclusion? Does the CPA firm toss the resume in the basket and protect an applicant? Or, do they contact the client company that is about to lose an executive and forewarn them? The answers are simple: Who pays their fees? Can the accounting firm suffer if that client suddenly loses an executive without substantial advanced notice?

Sometimes the employee is fired. I have met a number of them over the years.

I firmly believe that most of the professionals in the top accounting firms disapprove of these recruiting tactics. Their vote,

however, is out-weighed by the partners in charge of bottom-line results.

Where does it all end?

Perhaps when the courts tie in multi-billion dollar frauds to a conflict of interest resulting from personnel activities. Or perhaps that won't be necessary if the Congress takes an affirmative stand to prevent this inevitable fiscal monstrosity.

Thank you for inviting me to give you my views and to participate in your study.

Respectfully yours,

Robert Half

RH:jc

(FROM THE JOURNAL ON ACCOUNTANCY, JUNE 1971)

A study of companies that have recently gone public supports what many CPAs may have believed intuitively for some time—corporations planning to issue securities nationally for the first time often replace their local or regional CPA firms with national firms.

DISPLACEMENT OF AUDITORS WHEN CLIENTS GO PUBLIC*

BY CHARLES G. CARPENTER AND ROBERT H. STRAWSER

Many members of the accounting profession have frequently expressed concern with regard to the possible displacement of a CPA firm when for the first time a client issues securities nationally.

BACKGROUND

In the early 1960s, the Chief Accountant of the Securities and Exchange Commission, Andrew Barr, described certain of the accounting problems which arise when a client registers for the first time with the SEC in order to "go public." Barr emphasized at that time as well as on later occasions the willingness of his agency to assist CPAs who were inexperienced with SEC filings. At about the same time the then president of the American Institute of Certified Public Accountants, J. S. Seidman, also described some of the problems encountered in this area by practicing CPAs and suggested a number of solutions to them.

In his speech as outgoing AICPA president at the 1969 annual meeting, Ralph Kent identified auditor displacement as one of three major problems faced by the profession. His successor, Louis Kessler, established an *ad hoc* committee charged with the responsibility of identifying the extent and nature of the problem.

The AICPA committee on displacement distributed a questionnaire to CPAs who the committee believed might have encountered instances of displacement. The following section of this article presents the findings of this questionnaire research project, which approaches the problem from the viewpoint of the auditor. Subsequently, we present the findings of our research, which investigated a sample of corporations which have recently "gone public." The purpose of our research was to identify the extent of CPA firm displacement which arose as a result of these SEC filings.

AICPA STUDY

In the Institute's study, the committee sent questionnaires to approximately 2,400 AICPA member firms and received responses from 730 firms, about a 30 per cent response rate. Of these 730 firms, 165 (22.6 per cent) had participated in an SEC filing and, among these 165 firms, 103 (62.4 per cent) had at some time been displaced in an engagement which involved an SEC ruling by another CPA firm.

The respondents to this study indicated that:

> Almost universally, the reason expressed [for the change in auditors] was that the underwriters informed the client that a "nationally known firm" was necessary to sell their offering at the highest possible price.

Out of the 103 instances of CPA firm displacement reported to the AICPA study, 98 (95.1 per cent) were displacements by "nationally known firms." Where efforts to retain the client were successful, it was reported that strong client support

*Financial support for this research was provided by the Central Fund for Research, College of Business Administration, The Pennsylvania State University.

and the excellence of the firm's reputation were the primary considerations.

In the instances where displacement occurred, it is possible that the client may have decided to use the occasion of "going public" as an appropriate point to sever a relationship when otherwise he might have been reluctant to do so. Client needs may have grown to the point where the displaced firm was less able to provide the needed services; indeed, in 26 of the 103 cases (25.2 per cent) of displacement reported, the firm withdrew in recognition of its professional inabilities.

CURRENT STUDY

While the purpose of the AICPA committee's study was to ascertain the extent of CPA firm displacement by means of a questionnaire distributed to practicing CPAs, we sought to obtain similar types of information by contacting corporations which had recently "gone public."

Methodology. The authors obtained the names of all corporations which issued securities for the first time on an interstate basis and accordingly filed with the Securities and Exchange Commission under the Securities Act of 1933. The time period selected for the study was the last quarter of 1969 and the first quarter of 1970. These corporations were classified on the basis of whether the certifying accountants were a national public accounting firm, a regional or local public accounting firm, or, as we found in a few cases, both types of firms. Some of the prospectuses were then excluded from the sample if the organization was not a corporation, or if the organization was a foreign corporation (i.e., not American).[1]

A questionnaire was sent to the chief financial officers of the corporations remaining in our sample and to the corporations which had not responded to our initial request for a prospectus. The questionnaire sought answers to each of the following matters with respect to the corporation:

1. Is the auditor a national, or local or regional CPA firm?
2. Has the auditor been retained for less than five years, or five years or more?
3. If the auditor has been retained for less than five years or if management is contemplating a change in auditors, please identify the group from inside or outside the corporation which sought or is seeking the change.
4. What were or are the reasons for the actual or contemplated change?
5. What is the approximate size of the corporation in assets and income?

Results. We received 165 responses to our questionnaire from a total sample of 379, for a response rate of 43.5 per cent.

Of these responses, 137 corporations (83 per cent) reported that they had national CPA firms as auditors, 25 corporations (15.2 per cent) had small or medium-sized firms, and 3 corporations (1.8 per cent) had relied on opinions from both. Further analysis (see Exhibit I, page 57) appears to suggest that if the corporation had changed auditors within the last five years the probability was that its auditor was now a national firm.[2] If the corporation had not changed auditors within this time, the probability was that the auditor was not a national firm.

LOCAL OR REGIONAL CPA FIRMS AS AUDITORS

Twenty-five of the 165 respondents (15.2 per cent) indicated that their corporation retained a local or regional CPA firm as auditor. Of these, 15 corporations (9.1 per cent) had retained the auditor for five years or more. Only 3 respondents (1.8 per cent) indicated that a change in auditors was

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[1] Corporations of foreign background responded to our request for a prospectus by supplying a form which is substantially different from the normal prospectus and does not include either financial statements or an audit report.

[2] Included within these responses indicating auditor retention for less than five years would be those corporations which at the time of their response had been in existence for less than five years; however, these instances are not material.

EXHIBIT I

Analysis of Auditors of Respondent Corporations By Years of Retention

	Number	Per Cent
Auditor for five years or longer is a:		
National CPA firm	56	78.9
Local or regional CPA firm	15	21.1
	71	100.0
Auditor for less than five years is a:		
National CPA firm	81	89.0
Local or regional CPA firm	10	11.0
	91	100.0

being contemplated due to pressure exerted by management; in all of these instances pressure was exerted by the underwriter as well. In giving reasons for the contemplated change, 2 respondents stated that a national CPA firm would add prestige and "more reputation" to their financial statements, and 1 respondent complained of high CPA firm billings as the reason for change.

Ten respondents whose auditors were local or regional firms that had been retained less than five years stated that the actual or contemplated change in auditors was instigated by management in one instance and, in six other instances, instigated by a combination of sources: management, outside directors, underwriters, legal counsel and others. Three respondents stated that a dissatisfaction with the quality of service rendered by their accountants was the primary reason for a change, and one respondent referred to a change in management as the reason. In three cases respondents reported that the auditor had been retained less than five years since the corporation had been in existence for less than this period.

NATIONAL CPA FIRM AS AUDITORS

One hundred and thirty-seven financial officers reported that their corporations had retained national CPA firms as auditors. Of these, 56 (40.9 per cent) had been retained for at least five years and 81 (59.1 per cent) for less than five years.

Among the 56 corporations retaining auditors five years or more, only 6 (10.7 per cent) reported their corporations as considering a change in auditors. All 6 reported dissatisfaction with the quality of the CPA firm's service and 3 of the 6 also complained of excessive billings. All 6 also reported that the pressure for the change in firms arose from management and 1 of these respondents stated that the underwriters had also encouraged a change.

Eighty-one respondents reported that their corporations had retained their present auditors for a period of less than five years. In 3 instances this was due to a corporate existence of less than this period. Among those who commented on the reasons for changing auditors, the impetus for the change arose internally in 29 cases (61.7 per cent) and externally in 18 cases (38.3 per cent). This group of respondents reported that the specific source of the impetus for change in auditors (see Exhibit II, below) arose from several groups, with some respondents indicating more than one group.

Those respondents who indicated that the source of the pressure for the change in auditing firms arose from management identified the primary reasons for the change as the following: lack of satisfaction with the quality of service—including timeliness and accuracy—and cost of the auditor's fees; dissatisfaction with the former auditing firm's ability to supply "prompt, accurate information on current problems"; change in management; and desire for the reputation of a national accounting firm. The following reasons were also cited:

> Local office of national CPA firm considered our company a second class company insofar as audit schedules [were concerned]; and the CPA firm management's co-operation and interest were sadly lacking.
>
> Larger organization needed for statewide growth company.
>
> Unsatisfactory service from former CPA firm due to excessive dedication of personnel of former firm on a major consulting job for a competitor.

A number of corporate financial executives commented on the fact that underwriting influenced their choice of auditor. Exhibit III, page 58, reports the group from which the impetus for the change originated.

Of the respondents indicating their corporations had retained national CPA firms as auditors for less than five years, 17 reported that the impetus for the change had been external in nature: all 17 directly cited the underwriters as the specific source, with 1 respondent also citing legal counsel. The reasons

EXHIBIT II

Specific Sources of the Impetus For Changes In Auditors

Group	Number	Per Cent
Management	31	57.5
Underwriters	15	27.8
Outside directors	4	7.4
Legal counsel	2	3.7
New controlling stockholders	1	1.8
Other (not specified)	1	1.8
	54	100.0

EXHIBIT III

Sources of the Impetus for Changes in Auditors Where Underwriters Influenced the Choice

	Number	Per Cent
Underwriter	17	60.7
Underwriters and:		
Management	8	28.6
Legal counsel	1	3.6
Outside directors	2	7.1
	28	100.0

cited for the change were substantially the same, such as: "It was felt that the prestige of a national firm would be beneficial in making the public offering." Sixteen of these respondents reported asset and income size. Twelve of the 16 corporations had assets of less than $10 million; the median was $4.5 million. Thirteen had income of less than $1 million but more than $100,000; the median was $375,000.

In addition, 11 other respondents stated that the managements of their corporations recognized the benefits of having the opinion of a national firm, with 5 of these also indicating encouragement from the underwriters. The reason given by the respondents was similar to those responses referred to in the previous paragraph—that is, the corporation wished to achieve maximum assurance of the security issuance's selling as well as possible and, if this required the retention of a more widely recognized CPA firm, either management or its underwriters or both sought approval to do so. The comment of one respondent is particularly germane here:

> New management, after acquiring control of the company, had, in conjunction with the underwriters particularly, decided to have a national firm give their report on its accounts as an additional "marketing tool"—i.e., the public has more confidence in a national CPA firm than in a local CPA firm.

Another matter reported to be of some importance to many respondents was that a national CPA firm was somewhat more experienced in SEC matters than the local firm. The statements of several respondents seemed to imply that because the audit was for purposes of the SEC filing, they felt that they required the services of a national firm. Finally, it seemed that when the client went public, the corporation often underwent an analysis of the effectiveness of the CPA firm's ability to render auditing and other services; the result was that in some instances they concluded that the local or regional firm did not offer the expertise needed in some matters (SEC filings, systems and specialized industries were often mentioned) or that the local firm's offices were not geographically located so as to expedite the audit.

CONCLUSIONS

The results of the present study support what many accountants have no doubt believed intuitively for some time: local and regional firms are often replaced when a client "goes public." The reasons underlying the decision most frequently appear to be the prestige, reputation and greater technical ability (particularly in SEC matters) of a national firm. With management concerned with obtaining the most positive stock market reaction possible to the security issuance, substantial emphasis appears to be placed on a national firm reputation as a known stamp of financial statement reliability in order to achieve the greatest possible assurance management will indeed meet their objective. Thus, the results of this study tend to support the conclusions of the AICPA study.

The incidence of CPA firm displacement among corporations going public is apparently somewhat different from that among corporations which have been public for some time. Burton and Roberts reported several years ago that in an analysis of questionnaires and published annual reports they found changes of auditors among larger corporations were relatively rare, with a change in management a major reason for displacement.[3]

Thus, it seems that efforts by the profession to assist local or regional CPA firms in reducing displacements from clients "going public" must succeed in the following respects: (1) improve practitioner technical abilities; (2) improve existing intraprofessional referral activities for areas where smaller firms might not be reasonably expected to have such expertise; (3) educate clients of firm capabilities, or the firm's ability to obtain expert assistance should the need arise; and (4) persuade underwriters that the success of a security issuance is not dependent upon the national reputation of the auditing firm.

[3] John C. Burton and William Roberts, "A Study of Auditor Changes," JofA, April67, pp. 31-38.

(From The CPA, July, 1975)

A Proposal for Restructuring Our Profession

Eli Mason, CPA, has been president, first vice president, treasurer, and director of the NYSSCPA. He was vice president of the AICPA and has served on its council. A former president of the Foundation for Accounting Education, currently serving as chairman of the Board of Advisors of Baruch College, Mr. Mason is a member of the New York State Board for Public Accountancy and is managing partner of Mason & Company, CPAs.

The public accounting profession in the United States is in need of a vast restructuring. CPAs in every state require the same level of competence, adherence to technical standards, and conformity to ethical rules, and one would expect that the accounting profession was structured to effect uniformity in these and other areas. This is not the case. The current structure of voluntary associations and governmental authorities has resulted in inconsistencies and overlapping in areas such as promulgation of accounting and auditing standards, enforcement of ethical rules, and determination of basic entrance requirements to the profession. For example, accounting and auditing standards can be and have been established by the American Institute of Certified Public Accountants, state societies of certified public accountants, the Financial Accounting Standards Board, the Securities and Exchange Commission, state boards for public accountancy, various government agencies, and the Congress of the United States. Ethical rules (and the enforcement thereof) can be and have been established by the AICPA, state societies, state boards for public accountancy, the SEC, the Internal Revenue Service, etc. The prerequisites for achieving status as a certified public accountant are inconsistent and complicated by unequal legal requirements in 54 state and territorial jurisdictions.

The purpose of this article is to propose specific recommendations for reorganization of the profession on an integrated basis, with specific allocation of responsibilities between federal and state units. In this connection, it may be desirable to present a brief summary of the current structure of the profession and, specifically, of those voluntary associations and government agencies which exercise authority over accountants in public practice.

Voluntary Associations

American Institute of Certified Public Accountants

The AICPA is the foremost accounting organization in the United States. It is a membership group consisting of 110,000 members in all states, territories, and foreign countries. The Institute was

organized in 1887 and has provided many leaders in the field of accountancy. At present, its organizational structure consists of a board of directors, council, and officers. The chairman, chairman-elect, four regional vice presidents, and treasurer are nonsalaried members of the Institute who serve for a one-year term. It has a large staff including a full-time, salaried president who is a CPA, as well as four full-time, salaried vice presidents, two of whom are CPAs.

The Institute publishes periodicals, books, and educational course material. It maintains an Ethics Division with trial board machinery to deal with violations of the Institute's rules of professional conduct. It issues auditing standards but has relinquished the authority to establish accounting principles to the Financial Accounting Standards Board.

If a member of the AICPA is judged guilty of violating the Institute's rules of professional conduct, the most severe penalty is expulsion. However, since the Institute is a voluntary organization with no licensing authority, the violator could nevertheless continue to practice as a CPA.

Financial Accounting Standards Board

The FASB was organized in 1973 as the result of a study initiated by the AICPA. Prior to the study, the promulgation of accounting principles was the responsibility of the Accounting Principles Board. This board was the senior rule-making body of the Institute and for fourteen years, commencing in 1959, it issued 31 opinions on important topics. The APB consisted of 18 nonsalaried members of the Institute. The study group (known as the Wheat Committee) recommended that a new board be established, composed of seven full-time, salaried individuals, four of whom had to be CPAs drawn from practice. The FASB is supported by a staff and has an annual budget in excess of $2 million. The bulk of the budget is funded by the accounting profession and the major part of that support comes from the eight largest public accounting firms.

State Societies

Each state and territory has its own voluntary membership organization which varies in size, structure, and activities, ranging from the New York State Society of Certified Public Accountants with over 21,000 members to the Guam Society of Certified Public Accountants with 28. Officers and directors are nonsalaried members; staff is determined by the size and program of the society. Each society has rules of professional conduct which may not conform with the rules of professional conduct of the AICPA. If a member is found guilty of a breach of state society ethical rules, he may be expelled. However, as with the Institute, the violator may continue to practice as a CPA, since state societies are voluntary organizations and have no licensing or revocation power.

Governmental Agencies

State Boards for Public Accountancy

Authority for the issuance of a license to practice as a CPA in the United States rests with the state boards for public accountancy. These boards, in effect, have the statutory authority to confirm or revoke an individual's right to practice, which neither the AICPA nor state societies can do.

The state boards have additional functions. They determine the requirements to take the CPA examination and the qualifications to receive the CPA certificate and/or license.

It is obvious that basic regulatory authority rests with the state boards for public accountancy. However, due to the lack of licensing uniformity among the states, there is some confusion about the significance of the CPA designation. For example, in New York State, which has stringent requirements, an applicant may not take all four parts of the uniform CPA examination unless he has met both the educational and experience requirements. Fulfillment of these requirements, plus successful completion of the examination, enables the applicant to apply for a license as a certified public accountant. In contrast, Maryland has no experience requirement for the examination or the CPA certificate or license. An applicant who simply passes the CPA examination may engage in practice as a CPA in that state. In Illinois, one may take the CPA examination without meeting any experience requirement and, on successful completion of the examination, receive a CPA certificate. However, the new CPA may not engage in practice as a CPA until he has also completed certain experience requirements prescribed in Illinois, so as to obtain a license to practice. Therefore, in Illinois there are two types of CPAs—those with and those without a license to practice.

The administration and operations of the various state boards also differ in size, grievance machinery, and regulatory policies. This lack of uniformity in CPA qualifications is due to differences in enabling statutes enacted by various state legislatures, and is confusing to the profession as well as to the public. The public, which transacts business on a national basis, has the right to assume that all CPAs meet uniform entrance qualifications, standards of practice, and ethics.

Securities and Exchange Commission

The Securities and Exchange Commission was created in 1933 by an act of Congress. It consists of five commissioners and has far-reaching authority over security exchanges, publicly-owned companies, etc. The regulations pertaining to various reporting requirements place the public accounting profession in the vortex of SEC practice. Conformity to these accounting rules and regulations is supervised by a staff headed by the chief accountant of the SEC, who is a CPA. The chief accountant and his staff have various functions including review of submissions to the SEC, promulgation of accounting releases, and participation in disciplinary proceedings involving accountants who practice before the SEC. The SEC has the authority to determine auditing procedures and accounting principles for companies required to file with it.

The SEC has, over the years, issued rules of conduct for accountants pertaining to independence, fair presentation, etc. Under the applicable rules, the SEC has the authority to enjoin or suspend an accountant, or firm of accountants, from practice before the SEC. The authority of the SEC to censure accountants who practice before it is awesome and, in some cases, could terminate the practice of an accounting firm.

Other Groups

The current situation is further confused by the proliferation of different classes of accountants in various jurisdictions. For example, in New York State, the law provides for two classes—certified public accountants, a continuing class, and enrolled public accountants, a "dying" class. The latter group was permitted a one-time enrollment as

public accountants in 1960 and is licensed by and subject to the rules of the New York State Board for Public Accountancy.

In Indiana, there are three classes of accountants: certified public accountants, registered public accountants, and accounting practitioners. This last group is a continuing class and has no legal status in most states.

New Jersey has two classes of licensed practitioners—certified public accountants and registered municipal accountants, the latter class being the only group authorized to audit municipalities. Both groups are regulated by the New Jersey Board of Certified Public Accountants. However, in that state, public accountants are neither licensed nor registered and any person can be known and practice as a public accountant without regulation.

Review of the accounting statutes in the various states will reveal a high degree of confusion.

Proposed Structure

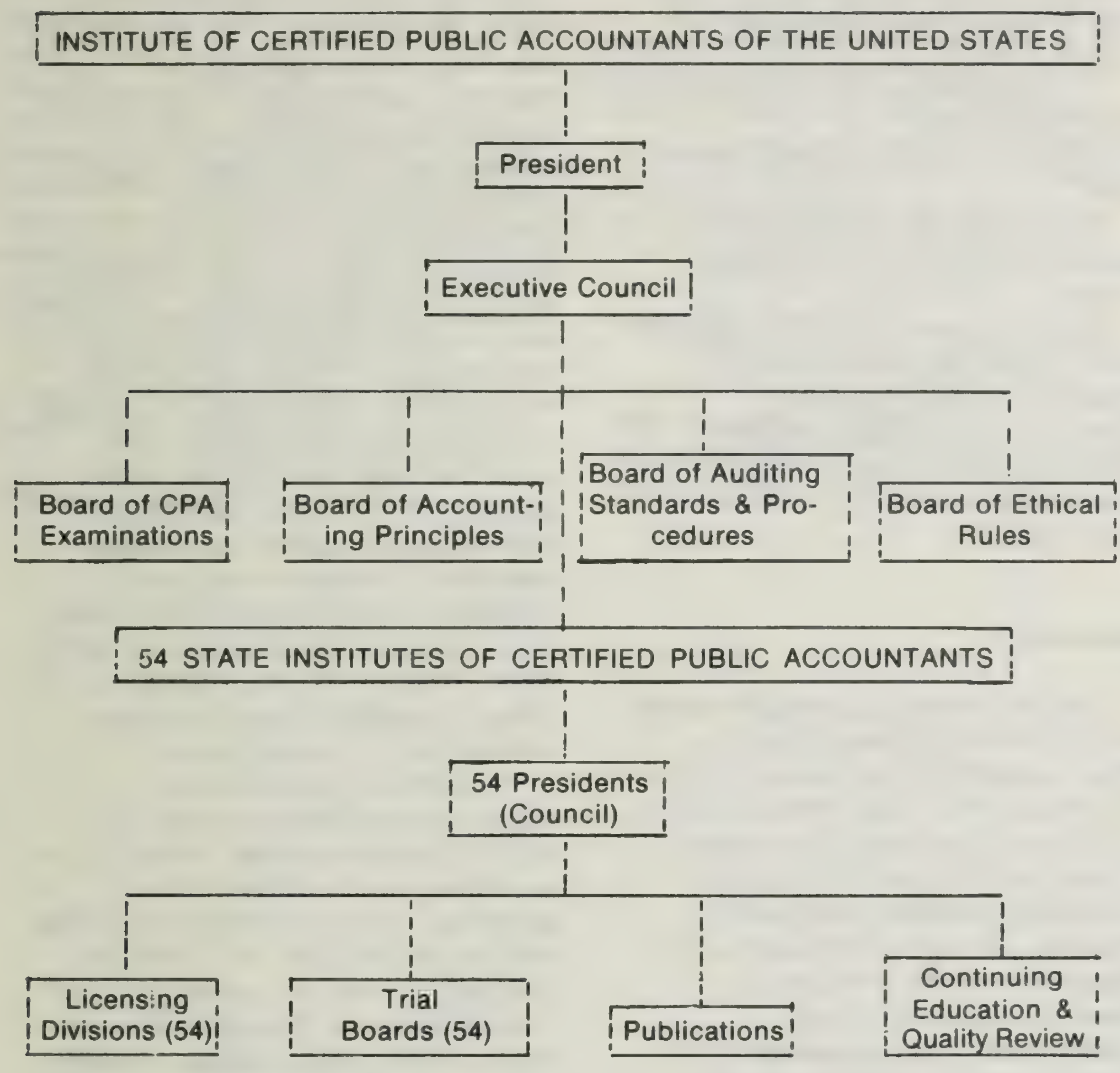
The foregoing summary of existing conditions in the accounting profession in the United States shows a lack of cohesive structure and, in fact, indicates conditions which may be detrimental to the public interest. The reason for the present situation is clear. There is a division of authority and purpose which can be cured by a new federal statute that will provide a meaningful and efficient structure for the practice of public accountancy in the United States.

It is proposed that the Congress of the United States enact legislation which would charter an Institute of Certified Public Accountants of the United States (U. S. Institute) to regulate all aspects of the practice of public accountancy. The law would also define and charter a substructure of institutes of certified public accountants in each state and territory. The promulgation of licensing requirements, accounting principles, auditing standards and procedures, and rules of professional conduct shall be the sole responsibility of the U.S. Institute. The administration of the rules, the supervision of CPA examinations, and the issuance and revocation of CPA certificates shall be the responsibility of the state institutes. Each state institute shall have officers, directors, and staff. The officers and directors shall be nonsalaried CPAs. Fees for CPA examinations, as well as annual dues for all licensed accountants, shall be paid to the state institutes who shall forward a specified amount per member to the U. S. Institute. Therefore, licensed CPAs would automatically become members of both the U. S. Institute and their state institute by payment of a single license fee. The CPA certificate would be national and would bear the signatures of the presidents of the U. S. Institute and the state institute.

The presidents of the state institutes shall constitute the *Council* of the U. S. Institute. Annually, they shall elect the president of the U. S. Institute, a past member of the Council, who shall be nonsalaried and serve for a one-year term. He will be the presiding officer of the Council and an *Executive Council.*

The Executive Council shall consist of 12 members including the Chief Accountant of the SEC, the Controller General of the U. S., the Assistant Commissioner of Internal Revenue—Technical, the immediate past president of the U.S. Institute, and seven current presidents of state institutes, elected by the Council. The Executive Council shall supervise an administrative staff, support staffs, and various boards that will promulgate accounting principles, auditing standards and procedures, CPA

PROPOSED STRUCTURE



examination requirements, ethical rules, etc. Members of the various boards shall be nominated by the Executive Council and confirmed by the Council.

Illustrated is a chart setting forth the recommended structure of the accounting profession in the U. S. under the proposed act of Congress.

Constitutionality

It may be asked whether federal regulation of the accounting profession would be within the power of Congress under the interstate commerce clause of the U. S. Constitution, and whether Congress could preempt the present system of state regulation.

We are advised that numerous decisions of the Supreme Court have held that Congress has the power under the commerce clause of the Constitution to regulate activities which are either in interstate commerce or which, if intrastate, substantially affect interstate commerce. As for the issue of preemption of states' rights, it would follow that if Congress has the power to legislate on a matter, the supremacy clause of the Constitution gives Congress the power to preempt state legislation. Usually the courts turn to an examination of the following points

in order to determine whether Congress intended state regulation to be preempted:

1. Is the federal act of regulation all pervasive?

2. Is the federal interest dominant?

3. Does enforcement of the state law conflict with the federal statute?

Further, federal bodies, such as the SEC, the IRS, and others, presently impose regulatory authority on those accountants practicing before them, thus clearly becoming involved in interstate commerce.

Conclusion

The proposed legislation would have the effect of integrating the public accounting profession in the U. S. for the first time. There would be uniform licensing requirements, uniform auditing standards and procedures, uniform accounting principles, and uniform rules of professional conduct, uniformly enforced, applicable to all practitioners in all states and to all federal agencies. The act should provide that standards, procedures, and principles delineated by the boards (authorized under the act) would apply to filings with all federal agencies.

Some may say that uniformity is desirable but that machinery to implement such uniformity should only apply to examination requirements, licensing, and revocation. They may contend that other areas of responsibility, such as promulgation of accounting standards and procedures, ethical rules, etc., should remain with existing organizations. If licensing requirements and revocation procedures are to be uniformly defined and enforced throughout the U. S., then rules of professional conduct, which are the underlying authority, must be uniformly defined and enforced. The same structure that issues and revokes licenses must set ethical standards. The most important precept of adherence to high ethical requirements is conformity to the standards of the profession. Obviously, these include auditing and accounting standards. The CPA who violates the standards of the profession is in basic breach of ethical rules and should be subject to disciplinary procedures. The body that sets rules for licensing and professional conduct should also set auditing and accounting standards if we are to achieve a meaningful and effective structure. This responsibility should not be divided between an organization with statutory authority and voluntary groups with no legal power.

Voluntary membership associations of accountants in public practice, private industry, or academia could and would continue, but finally there would be one set of rules for CPA practice. Naturally, there may be a period of "grandfathering" because of existing situations (e.g., status of public accountants, registered accountants, and other special classes).

The act would also provide authority for CPAs who receive their licenses in any state, territory, or possession to practice in any other state, territory, or possession, thereby obviating the current requirement for reciprocity. Public accountancy is a national professional endeavor and should not be hindered by artificial state boundaries.

Congress should also include in the act monetary limitations on accountants' liability so that the awesome spectre confronting the accounting profession today assumes reasonable proportions. At the same time, the public interest must continue to be protected.

Certified public accountants

would be naive if they did not recognize that the profession is under public scrutiny. The courts, the press, government agencies, and the public, in general, have expressed concern with various aspects of the profession. It is far better for the initiative to come from within the profession. Understandably, there may be dislocations and personal inconveniences as a result of the proposed legislation, but these are transitory. The certified public accounting profession in the U. S. is a permanent institution and the individuals involved are participants for limited periods.

Some may assert that the proposed legislation will create and enlarge federal authority over the profession. Time will prove that the interests of the profession and public will be best served by a uniform and meaningful federal statute rather than by the myriad of conflicting laws, rules, and regulations presently operating.

If the accounting profession is to face the future, it must do so with realism, courage, and dedication to the principle that the public interest is supreme. Ω

TIME, FEBRUARY 23, 1976

A Record of Corporate Corruption

The record of U.S. corporations indulging in bribes, kickbacks and political payoffs is already voluminous; yet it is sure to swell. The Securities and Exchange Commission is now investigating at least 54 major U.S. companies. The Internal Revenue Service is probing others. Here are the results so far:

During the Watergate investigations, a total of 17 companies confessed to making corporate contributions to help re-elect President Nixon. Why would they knowingly break the law? Some had much to gain or lose from federal action regardless of who won the election; many made corporate donations to the Democrats as well. Northrop Corp., which admitted a $150,000 donation to the Nixon campaign, is a major defense contractor. Three oil companies—Gulf, Phillips and Ashland—gave $100,000 each to Nixon; their industry is under political attack. American Airlines ($55,000) and Braniff Airways ($40,000) are dependent on federal regulators. But there were also companies among the 17 that had no obvious self-interest. Minnesota Mining & Manufacturing, makers of Scotch tape and other products, gave Nixon $30,000. Said former Chairman William L. McKnight: "I don't know that 3M did anything different than a great many other corporations."

The penalties were light. The Watergate Special Prosecutor's Office meted out tiny fines—usually $5,000 for the guilty corporation and $1,000 for the top officer—and closed its books. But the SEC, fearing that the political contributions had violated reporting rules, promptly reopened all the cases. It discovered several slush funds.

Gulf Oil, for example, used a Bahamas subsidiary to "launder" $12.3 million used for political purposes. The 3M Co. set up a Swiss bank account for the same purpose. Nor were the big multinationals the only influence seekers. Sanitas Service Corp., a Connecticut-based firm with 1975 sales of $83 million, passed $1.2 million to local politicians through a dummy concern founded by a former officer.

The SEC has demanded that the offenders promise to stop violating U.S. securities laws by concealing illegal contributions in their reports to the SEC and the public. Most companies let the matter drop at that point. Some exceptions: Ashland Oil chose to make Chairman Orin Atkins and two other executives pay the company $325,000 from their own pockets, and 3M got several officers, including former Chairmen Bert Cross and Harry Heltzer, to give back $480,000. Thomas V. Jones resigned as chairman of Northrop and is supposed to be replaced as president no later than June 16; after that, he may—or may not—stay on as chief executive. Gulf fired Chairman Bob R. Dorsey, even though his degree of knowledge of the slush fund was not proved.

When it discovers questionable payments overseas, the SEC orders an auditors' investigation of how much was paid where and to whom. Investigators have found that Northrop distributed a staggering $30 million to foreign agents. Some U.S. corporations were embarrassed by publicity about their contributions even in nations where the laws condone such gifts. IBM, Mobil and Standard Oil of Indiana, among others, made legal donations in Canada and Italy. Exxon contributed at least $46 million to Italian politicians, some of it in return for specific favors.

Until the Lockheed revelations, the payoff with the most explosive consequences was United Brands' 1974 payment of a $1.25 million bribe to a high official in Honduras to reduce an export tax on bananas. The bribe was uncovered by an SEC investigation into the suicide of United Chairman Eli Black, who swung his briefcase to smash a hole in a window of his office on the 44th floor of New York City's Pan Am Building and then jumped to his death. The disclosure helped bring on a Honduran coup that overthrew the government of President Oswaldo López Arellano.

Other scandals are still emerging or growing. It is not known yet exactly how many U.S. military officers and high-ranking Pentagon civilians accepted the hospitality of Northrop and other defense contractors at hunting lodges; the current count is 101. Some highly principled companies are investigating their overseas activities on their own. G.D. Searle, the pharmaceutical firm, last month announced that it had discovered payments of $1.3 million to "foreign government employees or their agents." While the making of such voluntary disclosures is admirable, it intensifies a troubling question: When will the scandals ever end?

NEWS RELEASE - - -

Congressman
WILLIAM J. HUGHES
2nd District • New Jersey
Committee on the Judiciary
Subcommittee on Monopolies & Commercial Law
Subcommittee on Crime
Select Committee on Aging
Ad Hoc Select Committee on the Outer Continental Shelf

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FOR RELEASE UPON RECEIPT 4/9/76

OIL FIRMS HIDE PROFITS THROUGH ACCOUNTING, HUGHES CHARGES

WASHINGTON, D.C. -- New Jersey Congressman William J. Hughes today accused 14 of the nation's 20 largest oil companies of using "creative accounting practices" to hide profits in 1974.

"Mobil Oil Company was fond of asking the question in full-page advertisements: 'What every happened to those obscene oil profits?' My study of annual reports submitted to the Securities and Exchange Commission has revealed that the profits are still there, they're just called something else," Hughes said.

The analysis showed that of the 20 largest U.S. firms from Exxon to Getty, 14 took write-offs, changed accounting policies, created reserves, or split stock with effects on reported earnings ranging from reductions of 0.5% to 100%. The largest category of the reductions came from a change in inventory accounting policy. As little as ten years ago virtually all of the 20 largest firms and many other industries used the first in, first out (FIFO) method of inventory accounting. Under this method, when sales were made inventory was reduced by the cost of those materials that were first purchased or manufactured. During a period of rising prices FIFO results in the least expensive materials being sold first and higher profits being reflected than if inventory had been reduced by the cost of those materials most recently acquired.

The latter is exactly what happens with last in, first out inventory accounting (LIFO). In 1974, when skyrocketing inflation and profits hit oil companies, nine of the 20 largest made a change from FIFO to LIFO, reducing their reported income by an average of 14%. The companies claim this change allows them to better match costs with revenues but it has the additional effect of reserving less costly materials in inventory that can be sold to produce higher profits in the future.

The nine companies which made the switch were Texaco, Standard Oil of California Standard Oil of Indiana, Occidental, Continental, Ashland, Marathon, Cities Service, and Standard Oil of Ohio. Some of the other changes were even more dramatic:

Standard Oil of Indiana issued a 100% stock dividend and restated prior years figures. Thus 1973 earnings were reported in 1973 as $7.33 per share and $3.67 per share in 1974. For 1974 Standard reported $6.86 per share. Without the stock dividend, Standard would have shown $13.72 per share.

Atlantic Richfield wrote off $21,700,000 as a result of withdrawal from a Canadian tar sands project announced in a previous year.

Cities Service reduced income by $21 million as a result of write-offs of plant, equipment and inventory costs at several locations.

Getty charged to income $55 million set aside for possible increases the Saudi Arabian and Iranian governments might mandate on production in their countries. Another $21 million was charged to income pending the outcome of a law suit.

Hughes' analysis was derived from information available in the companies' published financial statements and their form 10K reports, required by the SEC.

"We have heard a lot of rhetoric of late about the oil companies' bad year. The companies would have us believe that they have no control over their earnings. In fact, apart from operating control, they have taken advantage of flexibility in accounting methods to make their profits look like they want them to so as to manipulate public opinion. This sort of creative accounting, though perfectly legal, gives an erroneous picture on oil company profits to those who don't read every annual report footnote. The outcome is that these firms can, within broad parameters, manipulate their reported earnings as they see fit so that the public may never know what the truth really is," Hughes said.

(A copy of the full study is available upon request).

(From the Congressional Record, April 12, 1976)

OBSCENE PROFITS

HON. WILLIAM J. HUGHES

OF NEW JERSEY

IN THE HOUSE OF REPRESENTATIVES

Monday, April 12, 1976

Mr. HUGHES. Mr. Speaker, to the rhetorial question proffered by the oil industry, "What ever happened to those obscene profits?'" I submit the attached in partial explanation:

MAJOR OIL COMPANY FINANCIAL REPORTING SUMMARY

1974 was a year of extraordinary profitability for the oil industry in general. The companies have claimed publicly that the results were caused by one time inflationary pressures that they need every dollar to profit to explore for new reserves, and that in light of their historically poor return on invested capital the 1974 results merely got them to a fair level. At least the latter is true to some extent. Faced with a low return on capital, low earnings, or a bad financial picture most companies have traditionally taken advantage of flexibility in accounting procedures to make the company look as good as possible in any given years. As long as that is done consistently from year to year and company to company there is good comparability and the figures are easily understood. However, when as in 1974 companies are faced with extraordinary profits that may never be matched again the incentives are completely different. In that case companies are tempted to account for their success in such a way to make 1974's figures look less dramatic and to reserve some of the effect for later years when profits are not actually as good. Of the 20 largest oil companies, 14 of them succumbed to this temptation. They took write offs, changed accounting policies, created reserves and split stock with effects on reported earnings ranging from reductions of 0.5% to 100%. All of these things are disclosed in public financial statements or the Form 10K reports submitted to the Securities and Exchange Commission. However, since there is a strong tendency to look to the bottom line rather than comb the footnotes the public is left with the impression that the bottom line reflects the hard facts. Thus fair and accurate financial reporting gives way to the sort of creative accounting that allows companies to smooth their earnings and alter public and capital market conceptions of financial well being.

FINANCIAL REPORTING OF 20 MAJOR OIL COMPANIES

The major oil companies have become very familiar with the term "obscene profits" since the release of their 1974 financial statements. The principal reason given for the extraordinary figures was one time inflationary pressures exerted both within the market and by OPEC exercising its new found control over the world's energy supply. The impression given is then that the major U.S. companies had no control over their reported profits. Nothing could be farther from the truth. Quite apart from operating control each of these companies has wide latitude within so called Generally Accepted Accounting Principles to report its operations in published financial statements. That means that in any number of ways a company can make its earnings look better or worse in any given year, not arbitrarily and capriciously but significantly and still report fairly enough to get a clean opinion from their accountants.

To the extent that this is done the goal of the companies is to show a steady upward trend in income. Generally that means using every accounting device available to them to make earnings look better. This creates a better market perception of their stock and any debt they may need to issue. However, the benefits are short lived if earnings take a huge leap in one year and the growth curve cannot be maintained thereafter. Whether or not the big oil companies could have predicted the adverse public opinion to their reported profits, they knew they couldn't repeat them in subsequent years with a steadily decreasing supply of raw materials. Thus in a very real sense there was strong incentive to temper the dramatic increase in reported profits in 1974 and reserve some of them in order to report them in subsequent years.

Clearly the 20 largest oil companies with some exceptions have taken advantage of this flexibility in acounting procedures. There is absolutely nothing illegal about this sort of activity. Most of it gets by under the guise of "Good Conservative Accounting." In fact, corporate officers and directors are under a legal duty to use their best efforts and good business judgment to maximize return on investment for stockholders. Whether failure to take advantage of flexible accounting methods is a breach of duty to stockholders is very doubtful. Considerably less doubtful however, is the fact that the public has been to some extent misled into thinking that reported earnings reflect very precise figures over which the companies have no control. In fact those companies could have reported considerably higher profits in 1974 than they actually did as the figures to follow will show:

1. Exxon added $40 million to investment reserves which it deducted from current revenues in addition to another $38 million

simply allocated to other reserves. It is not possible to tell from previous reports whether this is standard procedure or an extraordinary sum. In any case it could be nothing more than conservative treatment although it could have been included in income amounting to a 2 percent increase over that reported.

2. Texaco changed from First in First Out (FIFO) inventory accounting to Last in First Out (LIFO) accounting for crude oil, petroleum products, and petrochemical inventories in the United States as of January 1, 1974. This change is one that many companies in a wide variety of industries have adopted in the face of continued inflation. Its effect is to charge inventory with those raw materials last purchased or produced so that in inflationary times the income reported will be less than if those items first purchased or produced were charged to inventory first. A major reason why most companies have made the change is that the Internal Securities and Exchange Commission requires registered companies to use the same inventory accounting policy for financial reporting purposes as for tax purposes. Texaco uses the reasoning that LIFO more closely matches current costs with current revenues. That is no doubt true but it also has the effect of reserving some profits in inventory for some future time and in 1974 reduced income by $196,700,000 or $.72 per share.

3. Mobil's income increased only 23 percent in 1974, a relatively small amount compared to others among the top 20. As a result Mobil took advantage of additional funds to increase dividends by $.40/share and purchase Marcor rather than reserving the profits by accounting techniques. The purchase of Marcor had no immediate effect on earnings and Mobil claims it would not have had the 1974 figures been consolidated. There appears to be at least some dilution forthcoming in that Mobil's return on capital without Marcor was roughly 12 percent. Mobil paid $832,000,000 for 54 percent of Marcor which earned $96,652,000 in 1974. Mobil's 54 percent would be worth only 6 percent on its $832,000,000.

4. Standard Oil of California saw its income increase from $844 million in 1973 to $970 million in 1974. The per share data looks similar increasing from $4.97/share to $5.71/share but would have looked substantially more dramatic had Standard not split its stock 2 for 1 in 1973. It is difficult to speculate as to whether this was done in anticipation of a big year in 1974 either in whole or in part because of the countless other potential reasons available. Whatever the reason it was certainly well timed to keep per share figures from looking exorbitant. Standard of California took a similar step in 1974 by extending LIFO inventory accounting to foreign operations. The result was to reduce 1974 reported income by $250 million or $1.47 per share. Since reported income was up only $.74 per share or 15% over 1973 income the extension of LIFO reduced the increase by 66 percent and avoided having to report a 44 percent increase in income in 1974. There are several legitimate reasons for shifting to LIFO but if the purpose were smoothing of reported income their timing was flawless.

5. Gulf's income rose 25 percent from $800 million in 1973 to $1,065 million in 1974. It is not apparent that Gulf has tried to reduce this amount and in fact spent $341 million purely out of working capital to buy 13 million shares of its own stock in 1973. This is not surprising since even with the increase Gulf did not quite reach an 11 percent return on invested capital so there was little incentive to report a lesser income. They had any number of problems in other areas including illegal contributions without trying to cut down a 25 percent increase in income.

6. Standard Oil of Indiana issued a 100 percent stock dividend in December of 1974 which resulted in reported earning per share of $6.86 in 1974 as opposed to $7.33 in 1973. Adjusted the 1973 figure is reported as $3.67 leaving one to search the footnotes to find the stock dividend. Without it the reported figures would have been $7.33 in 1973 and $13.72 in 1974. Undoubtedly Standard has sound arguments for increasing its capital base to provide greater accessability to the capital markets in the future but for pure cosmetic effect on the absolute amounts reported in a time when oil companies were taking a lot of criticism for windfall profits the stock distribution is a marvelous device. So effective in fact that Standard was able to shift from FIFO to LIFO accounting for chemical inventories and claim that it had no material effect on earnings. When net income jumps from $511 million to $970 million in one year it takes a lot more to be material than it did the year before.

7. Shell already takes advantage of most of the accounting devices that would reduce income but they did adopt price level adjusted financial reporting to more accurately reflect actual standing in inflationary times. The net result was to reduce reported income by $3,000,000 or $0.04 per share.

8. Conoco adopted LIFO on January 1, 1974 reducing earnings for the year by $71 million or $1.40 per share. They also adopted price level adjusted accounting reducing 1974 earnings by 8 percent. The total effect is a 30 percent reduction in reported income purely as a result accounting changes. Without them income in 1974 would have been up 70 percent over 1973.

9. Arco wrote off $21,700,000 in 1974 as a result of a previously announced withdrawal from a Canadian tar sands project.

10. Occidental Petroleum's income increased 391 percent from 1973 to 1974 but only 60 percent over 1970 because of a succession of bad years in between. They took

advantage of the occasion to change to LIFO and hardly missed the $48 million the change eliminated from reported earnings. They also took a $42 million loss from discontinued operations as compared to $5, $9, $5, and $48 million in such losses in 1970 through 1973 respectively. Further they went ahead and adopted a new Financial Accounting Standards Board policy which requires expensing certain research and development costs as incurred. The principle was to take effect in 1975, and was standard procedure for most of the major oil companies already. Occidental had been capitalizing certain of those expenditures with the result that their reported income was increased by approximately $6 million each year from 1970 through 1973. Now that they do not need the extra income they have adopted the statement one year early reducing their income by $4 million in 1974. This does not appear to be the first time that Occidental has taken advantage of generally accepted accounting principles. Back in 1971 their worst year of the five examined, Occidental established a $65,000,000 reserve against possible future losses on chartered tankers due to potential cutbacks in oil from Libya. In any year that would be a very conservative action but since Occidental was reporting a loss for 1971 they appear to have indulged in "The Big Bath," an accounting phenomena whereby companies suffering a bad year decide nothing else can hurt and take advantage of the occasion to clean up their accounts. That often means writing off bad results carried over from past years or clearing the way for better years in the future. That was certainly the result of Occidental's 1971 actions and their 1974 efforts strike a similar note though in different circumstances. They seem to have a very versatile accounting staff.

11. Tenneco began on January 1, 1974, to provide for deferred federal income taxes applicable to the current difference between financial income and taxable income arising by virtue of tax deductions applicable to oil and gas exploration, development and production activities. Prior to that they had flowed through those benefits to current income. The result was to reduce net income by $46,000,000 or $.66 per share in 1974.

12. Phillips petroleum adopted deferred tax accounting for a Canadian subsidiary in accord with recommendations of Canadian Institute of Chartered accountants. This reduced reported income by $28 million or $36 per share. They also closed down a 94 percent owned Puerto Rican subsidiary because of uneconomical operations, resulting in a $63 million loss. However, they also sold their interest in some Japanese fertilizer companies at a profit so the net charge to income was only $9 million.

13. Union Oil made no significant accounting changes in 1974. There were procedures adopted by the other companies available to them and their income increased from $180 million in 1973 to $288 million in 1974. However, they were probably hampered to some extent by a hung issue of 7.8 million shares of convertible preferred stock callable at $65 per share and convertible into 10.15 million shares of common stock. Since the common stock ranged in price from $56¾ down to $27¼ in 1974 that preferred is not likely to be converted. That sort of situation creates problems when a company wants to issue new stock or debt to raise capital. The chances are they hoped to get it converted before they took any sort of steps that would reduce earnings.

14. Sun Oil took a loss of $5 million on the divestiture of Red Barn Chemical Company. They also did an unusual thing in the statement of earnings per share: they stated them in terms of earnings per share after preferred cash dividends. Most companies state eps before provision for preferred dividends or give before and after figures. Since money expended for preferred dividends is not available to common stockholders Sun's method is perfectly proper and they have followed it for years but it did make their income per share look relatively less high than the other companies. Sun is one of the few major oil companies still controlled by a single family and that may have some effect on the manner in which preferred dividends are treated.

15. Amerada Hess made no significant accounting changes in 1974. Significantly their income was down from 1973 even disregarding a $27 million extraordinary addition in 1973 which had been deducted from income in 1972, their worst year in the past 10.

16. Ashland switched entirely to LIFO reducing income by $35,000,000 or $1.48 per share.

17. Marathon had already switched to LIFO in 1973 but made no further changes or extraordinary write-offs in 1974.

18. Cities Service reduced 1974 net income by $21 million as a result of write-off of plant, equipment, and inventory costs at several locations. However, they had an $8 million increase in income due to restoration of an excess reserve provided in prior years for helium royalty expenses. They also extended use of LIFO reducing income by $13 million and cancelled plans to construct petroleum processing facilities in Lake Charles, Louisiana at a loss of $9 million after taxes.

19. Getty's income nearly doubled in 1974, rising $281 million from $142 million, and $15.00 per share from $7.54. It is interesting to note that in 1973 their taxes equaled $84 million while their theoretical tax amount was $112 million. In 1974 their income tax expense was $316 million and the theoretical tax amount $304 million. The 1973 figures are what one would expect, less income reported for tax purposes than for financial reporting purposes. The 1974 figures reflect exactly the opposite meaning that there were deductions taken for financial reporting purposes that could not be taken for tax purposes. Those deductions include a $45 million

charge to income to establish a reserve for possible increases in the Saudi Arabian government take for production in that country. They established a similar $10 million reserve for Iranian operations. Finally, they established a $35 million reserve for amounts in dispute with Phillips which reduced income by $21 million. That amount has already been recredited to income in 1975 after the suit was settled.

20. Standard Oil of Ohio (SOHIO) is harder to compare as a result of the 1970–71 merger with British Petroleum, a 2 for 1 stock split in 1973, and a 1973 inventory accounting change relating to the sale of inventories between subsidiaries. Nevertheless Sohio's 1974 income more than doubled over that in 1973 in spite of an extension of LIFO to chemical inventories reducing income by $3 million or $0.80 per share.

CONCLUSIONS

The published financial reports of the twenty largest oil companies indicate a clear trend toward taking advantage of generally accepted accounting principles to reduce reported income. Fourteen of the twenty firms examined made some change in accounting policy or indulged in some write,off that had the result of causing less income to be reported in 1974 than would otherwise have been possible. The changes ranged in magnitude of their effect on reported earnings from 0.5% to 100%. They included nine switches to LIFO, 4 companies taking write-offs for discontinued operations, one 100% stock dividend, and one set of very imaginative reserves that were established. Any one of these in isolation might not even be interesting but the fact that virtually every company that did not suffer some serious disability took a major step that had the effect of reducing reported income significantly is hardly a coincidence. Despite whatever public relations message they seek to convey about needing every cent for exploration this study shows that the 20 largest oil companies took steps that would ease public outcry about windfall profits and reserve some portion of those profits for later years. While it is difficult to read any particular motivation into the actions taken it is nevertheless clear that cosmetic effect had some part in them. Unfortunately a large part of the public believes that reported financial statements reflect a company's financial position exactly. Thus the figures that the public is accepting as precise can be and in fact are being manipulated by these companies in a way that to some extent obscures the actual results of the years' operation. Flexibility in SEC rules and generally accepted accounting principles is intended to enable companies to accurately reflect their financial position in light of the economic realities particular to the company reporting. To use that flexibility enhance their public image to the extent done here may not be scandalous but it is at best a questionable practice.

Company	Reported income (millions)	Available income (millions)	Difference (millions)	Percent of reported	Reported EPS	Potential EPS	Difference	Percent of reported
Exxon	3,142	$3,220	$78	2.0	$14.04	$14.39	$0.35	2.0
Texaco	1,586	1,783	197	12.0	5.84	6.56	.72	12.0
Mobil	1,047	NC	NC	NC	10.28	NC	NC	NC
Standard Oil of California	970	1,220	250	26.0	5.71	7.18	1.47	26.0
Gulf	1,065	NC	NC	NC	5.47	NC	NC	NC
Standard Oil of Indiana	970	NC	NC	NC	6.86	13.72	6.86	100.0
Shell	620	623	3	.5	9.21	9.25	0.4	.4
Conoco	328	428	100	30.0	6.47	8.43	1.96	30.0
Arco	475	497	22	5.0	8.36	8.75	.39	5.0
Occidental	281	375	94	33.0	3.77	5.26	1.49	40.0
Tenneco	321	367	46	14.0	3.43	4.09	.66	19.0
Phillips	402	439	37	9.0	5.30	5.78	.49	9.0
Union	288	NC	NC	NC	7.03	NC	NC	NC
Sun	378	383	5	1.0	8.31	9.34	1.03	12.0
Amerada Hess	202	NC	NC	NC	5.32	NC	NC	NC
Ashland	113	148	35	31.0	4.45	5.93	1.48	33.0
Marathon	170	NC	NC	NC	5.70	NC	NC	NC
Cities Services	204	239	35	17.0	7.58	8.88	1.30	17.0
Getty	281	357	76	27.0	15.00	19.06	4.06	27.0
Sohio	148	151	3	2.0	4.03	4.11	.08	2.0